BUDGET TREATMENT OF THE FEDERAL FINANCING BANK

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

SECOND SESSION

APRIL 4, 1984

Serial 98-66

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE
34-607 O WASHINGTON : 1984

H781-50

COMMITTEE ON WAYS AND MEANS

DAN ROSTENKOWSKI, Illinois, *Chairman*

SAM M. GIBBONS, Florida
J. J. PICKLE, Texas
CHARLES B. RANGEL, New York
FORTNEY H. (PETE) STARK, California
JAMES R. JONES, Oklahoma
ANDY JACOBS, JR., Indiana
HAROLD FORD, Tennessee
ED JENKINS, Georgia
RICHARD A. GEPHARDT, Missouri
THOMAS J. DOWNEY, New York
CECIL (CEC) HEFTEL, Hawaii
WYCHE FOWLER, JR., Georgia
FRANK J. GUARINI, New Jersey
JAMES M. SHANNON, Massachusetts
MARTY RUSSO, Illinois
DON J. PEASE, Ohio
KENT HANCE, Texas
ROBERT T. MATSUI, California
BERYL ANTHONY, JR., Arkansas
RONNIE G. FLIPPO, Alabama
BYRON L. DORGAN, North Dakota
BARBARA B. KENNELLY, Connecticut

BARBER B. CONABLE, JR., New York
JOHN J. DUNCAN, Tennessee
BILL ARCHER, Texas
GUY VANDER JAGT, Michigan
PHILIP M. CRANE, Illinois
BILL FRENZEL, Minnesota
JAMES G. MARTIN, North Carolina
RICHARD T. SCHULZE, Pennsylvania
BILL GRADISON, Ohio
W. HENSON MOORE, Louisiana
CARROLL A. CAMPBELL, JR., South Carolina
WILLIAM M. THOMAS, California

JOHN J. SALMON, *Chief Counsel*
JOSEPH K. DOWLEY, *Assistant Chief Counsel*
ROBERT J. LEONARD, *Chief Tax Counsel*
A. L. SINGLETON, *Minority Chief of Staff*

CONTENTS

Page

Press release of Wednesday, March 21, 1984, announcing the hearing 1

WITNESSES

Department of the Treasury, Thomas J. Healey, Assistant Secretary for Domestic Finance 14
Office of Management and Budget, Joseph R. Wright, Deputy Director, and David G. Mathiasen, Deputy Assistant Director for Budget Review 4
Congressional Budget Office, Rudolph G. Penner, Director 30

Mortgage Bankers Association of America, James A. Abbott, Burton C. Wood, and William E. Cumberland 34
National Housing Conference, Inc., Carl A.S. Coan, Jr 75
National Rural Electric Cooperative Association, Charles A. Robinson, Jr., and Don Smith 84
National Telephone Cooperative Association, Joseph Vellone 92
Salomon Bros., Inc., Miner H. Warner 45

SUBMISSIONS FOR THE RECORD

National Association of Manufacturers, Alexander Trowbridge, statement and attachment 97
Tennessee Valley Authority, Charles H. Dean, Jr., statement 102

BUDGET TREATMENT OF THE FEDERAL FINANCING BANK

WEDNESDAY, APRIL 4, 1984

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 9:30 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons presiding.

[The press release announcing the hearing follows:]

[Press release of Wednesday, Mar. 21, 1984]

THE HONORABLE DAN ROSTENKOWSKI (D., ILL.), CHAIRMAN, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES HEARINGS ON THE BUDGET TREATMENT OF THE FEDERAL FINANCING BANK

The Honorable Dan Rostenkowski, (D., Ill.), Chairman of the Committee on Ways and Means, U.S. House of Representatives, today announced that the Committee will hold an additional hearing on altering the budget treatment of programs financed through the Federal Financing Bank, as proposed in H.R. 4629, the Truth-In-Budgeting Act of 1984, introduced by the Honorable Bill Gradison (R., Ohio).

Last year, on May 12, 1983, the Committee held a hearing on H.R. 2868, also introduced by Congressman Gradison. On June 30, 1983, Congressman Gradison introduced H.R. 3484, an amended version of the earlier bill which reflected comments received at the May hearing. H.R 4629 represents a further refinement of these concepts.

The hearing will be held on Wednesday, April 4, 1984, beginning at 9:30 a.m., in the Committee's main hearing room, 1100 Longworth House Office Building.

I. BACKGROUND

Federal Financing Bank.—The Federal Financing Bank (FFB) was created in 1974 as an off-budget Federal agency in the Treasury Department as a means of coordinating Federal borrowing efforts to minimize disruption in the money markets by Federal borrowing, and to reduce the costs of Federal borrowing from the public. The FFB is authorized to purchase the obligations issued by any Federal agency and obligations guaranteed by Federal agencies. The FFB borrows directly from the Treasury, and the Treasury in turn borrows that amount in addition to the borrowing needed to finance the budget deficit. Hence, the Federal debt is increased as the Treasury borrows to accommodate the FFB. Such debt is subject to the limitation on the public debt.

Because of the process used in purchasing new guaranteed loans, FFB purchases of such guaranteed loans have the effect of converting agency guaranteed loans into off-budget direct loans of the Federal Government. When the FFB purchases the loan assets of other Federal agencies, the effect is to transfer direct agency loans into off-budget loans of the FFB.

The Administration expects the off-budget outlays of the FFB to be $10.2 billion for Fiscal Year 1985, with more than 80 percent relating to loan programs of the Farmers Home Administration, Rural Electrification and Telephone Revolving Fund, and foreign military sales credit. During recent years, questions have been raised about the appropriateness of the current budget treatment of FFB outlays.

II. SCOPE OF THE HEARING

The hearing will permit the Administration and other interested parties to present their recommendations on H.R. 4629 (and predecessor bills) to revise the budget treatment of the Federal Financing Bank.

This legislation has the objective of reflecting agency transactions with the Federal Financing Bank in the budget and in the agency's budget account. H.R. 4629 clarifies that the off-budget status of an agency would not be affected by the bill but rather that only its transactions with the FFB would be shown in the budget. H.R. 4629 also revises the provisions which determine when an agency would be required to use the FFB. Under the revised bill, programs which were financed outside of the FFB in FY 1983 could continue to use private financial markets to the same degree their activities were financed in those markets in FY 1983. After September 30, 1984, a Federal agency would generally have to offer its obligations to the FFB first. Criteria are set forth for FFB purchases and for approving agency requests to use private markets. These provisions would be effective October 1, 1984.

In announcing this hearing, Chairman Rostenkowski observed, "This hearing will provide a further opportunity to review the operations of the Federal Financing Bank and its off-budget status. In 1983, the First Concurrent Budget Resolution explicitly recommended that the appropriate committees with jurisdiction over the FFB consider legislation to require that transactions with the FFB be included in the budgets of the initiating agencies. The Committee on Ways and Means is continuing its efforts to fulfill that mandate."

Details for submission of requests to be heard

Individuals and organizations interested in presenting oral testimony before the Committee must submit their requests to be heard by telephone to Harriett Lawler [(202) 225–3627] no later than Thursday, March 29, 1984, to be followed by a formal written request to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesman to represent them in order for the Committee to hear as many points of view as possible. Time for oral presentations will be strictly limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This process will afford more time for members to questions witnesses. In addition, witnesses may be grouped as panelists with strict time limitations for each panelist.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Committee are required to submit 200 copies of their prepared statements to the Committee office, room 1102 Longworth House Office Building, at least 24 hours in advance of their scheduled appearance. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

Requests to be heard must contain the following information: (1) The name, full address, and capacity in which the witness will appear, as well as a telephone number where he or his designated representative may be reached; (2) a list of any clients or persons, or any organization for whom the witness appears; and (3) a topical outline or summary of comments and recommendations.

The above information should also be incorporated in the prepared statements to be presented in person as well as those filed for the printed record of the hearing.

Written statements in lieu of personal appearance

Persons submitting written statements for the printed record of the hearing should submit at least six (6) copies by the close of business, Friday, April 6, 1984, to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and the interested public, they may provide 100 additional copies for this purpose to the Committee office before the hearing begins.

Mr. GIBBONS. Good morning, ladies and gentlemen.

This is a hearing of the Ways and Means Committee on the Federal Financing Bank. We are here today to examine the budget status of the Federal Financing Bank. The Federal Financing Bank

was created in 1973 to organize Federal agency borrowing. Its activities were put off-budget to avoid double counting of outlays recorded in accounts of agencies that borrow from the Federal Financing Bank. Since this time, however, the Federal Financing Bank's off-budget status has also become a vehicle for some agencies to keep lending outlays from being recorded in the budget.

Agencies such as Farmers Home Administration, the Rural Electrification Administration, sell loans to the Federal Financing Bank or arrange for direct Federal Financing Bank financing of agency loan guarantees; hence, direct federal lending originating within these agencies is recorded only in the off-budget accounts of the Federal Financing Bank.

This practice defeats the purpose of the constraints established by the Congressional Budget Act of 1974. It means that spending for some activities escapes the scrutiny of the budget process and allows them to bypass the level playing field on which all other programs must compete.

To address this problem, our distinguished member, Mr. Gradison of Ohio, has introduced H.R. 4629, the Truth in Budgeting Act of 1984. The bill would require that transactions of the Federal Financing Bank be recorded in the budgets of the originating agencies, thus insuring that all agency transactions are taken into consideration as budget resources are allocated.

There are two questions I would like to address at this hearing: what is the proper budgetary treatment of the Federal Financing Bank—and let me repeat that again—what is the proper budgetary treatment of the Federal Financing Bank, and what programs, if any, should be required to make use of the Federal Financing Bank to finance their obligations.

Mr. Gradison, do you wish to make a statement at this time?

Mr. GRADISON. Well, Mr. Chairman, I want to thank you for holding this day of hearings on the budgetary treatment of the Federal Financing Bank. As you know, my interest in reforming the accounting practices of the FFB is rooted in Congress loss of control over FFB finance loans, an inadvertent but nonetheless important side effect of the very useful development of the Federal Financing Bank. H.R. 4629 represents refinement over earlier bills I have introduced over the past two Congresses. I believe that H.R. 4629 balances the various concerns over the bill without compromising the bill's intent.

Many of the changes in it over previous versions were the result of the hearings held by this committee on the Federal Financing Bank in May of last year. The bill is narrowly drawn. It is to correct the lack of comprehensiveness in the present so-called unified budget. It is in no way prejudicial to any agency program. My intent has been to put all FFB finance spending in the unified budget and within the accounts of the originating agencies.

Mr. Chairman, I look forward to hearing testimony today from interested parties, and hope that the committee will soon move to put an end to the budgetary abuses wrought by some of the accounting practices which relate to the operations of the Federal Financing Bank.

Thank you, Mr. Chairman.

Mr. GIBBONS. Mr. Gradison, I want to congratulate you. Yours is an intelligent and courageous piece of legislation. I well remember the creation of the Federal Financing Bank right here in this room.

Mr. Paul Volcker, who is now the Chairman of the Federal Reserve, was at that time an Assistant Secretary of the Treasury, and his purpose in creating the Federal Financing Bank, as explained to us right here in this room, was merely to provide for orderly transition of these federally related agencies to go out and seek money in the market and not disrupt the marketplace.

It was more of a regulatory agency than it was to be an agency of—as a side door to the Treasury. And, frankly, it was never discussed as to whether or not these items would be totally off-budget. No one thought we were disturbing the budget process at that time as we even understood it in those days.

So what you do makes good sense, Mr. Gradison.

Our first witness this morning is Mr. Joseph Wright, the Deputy Director of the Office of Management and Budget, followed by Mr. Thomas Healey of the Treasury Department.

Mr. Wright, you may proceed first, and then Mr. Healey.

STATEMENT OF JOSEPH R. WRIGHT, DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, ACCOMPANIED BY DAVID G. MATHIASEN, DEPUTY ASSISTANT DIRECTOR FOR BUDGET REVIEW

Mr. WRIGHT. Thank you, Mr. Chairman.

I also have Mr. David Mathiasen, who is the Deputy Assistant Director of the Budget Review Division. I do have a 13-page testimony, Mr. Chairman. I am sure you will be delighted that I will just submit it for the record.

Mr. GIBBONS. Without objection, it will be placed in the record, but I hope you will cover it thoroughly.

Mr. WRIGHT. Yes; I will summarize it very briefly.

We are delighted to be here to testify on H.R. 4629, and, as you know Mr. Gradison, we fully support the intent of this legislation. We think that it strengthens the budget process and the unified budget, and it is overdue. It is consistent with the President's Commission on Budget concepts in 1967, in that it requires outlays from the credit transactions with the FFB to be recorded in agency budgets.

I believe, Mr. Chairman, that this agreement on our part that the requirement that these outlays be recorded is an important change in the way we do business right now is a partial answer to your first question. That is the way that we feel budgeting should be done within the Federal Government, and the concept of a unified budget should be preserved and maintained. Unfortunately, we have had exceptions over the years.

Second, the bill it includes off-budget entities in the unified budget, and third, it generally prohibits agencies from borrowing from private credit markets without first offering their obligations to the FFB.

We think the last provision is important. I will let Mr. Healey cover it in more detail, but the FFB is in some cases one of the

most efficient methods of financing that we have within the Federal Government and we should use it.

We do have some technical concerns and suggested revisions, primarily concerning the way the attribution of outlays are made to the agencies' budgets, and we would be happy to work with the committee on that language. We think it needs to be beefed up and clarified somewhat.

Mr. GIBBONS. We would certainly like to have your help on that.

Mr. WRIGHT. Second, we have some concern about the grandfathering on those agencies who are currently financing outside of the FFB. What we would prefer is not have an automatic grandfather clause within the legislation, but to put in a waiver provision under the auspices of the Department of the Treasury and work it out through that vehicle.

Other than that, we generally support the intent of the bill and would be happy to work with the committee on refining the language. We will also be working together on the Senate side with S. 2213.

Thank you very much, Mr. Chairman.

[The prepared statement follows:]

34-607 O—84——2

STATEMENT OF JOSEPH G. WRIGHT, DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. Chairman and Members of the Committee:

I am here today to present the Administration's view of H.R. 4629, the "Truth-In-Budgeting Act of 1984". This bill would require that outlays arising from credit transactions financed by the Federal Financing Bank (FFB) on behalf of Federal agencies would be recorded as outlays in those agencies' budgets. Budget authority used by the FFB would be attributed to the agencies. In the case of off-budget Federal entities, the amounts would be included in the unified budget. The bill would also generally prohibit agencies from borrowing directly from the private credit markets by issuing obligations of a type ordinarily financed in the investment securities market without first offering those obligations to the FFB.

Administration Position

The Administration supports the efforts of Congressman Gradison and this committee to improve the review and control of Federal outlays by including the outlays of FFB-financed programs in the budget totals and by charging these outlays to the responsible agency. At the same time, the bill would prevent agencies from avoiding the improved budgetary control process through the device of financing their programs through fully guaranteed obligations of a type ordinarily financed in the investment securities market. Thus, it would improve budgetary control while maintaining the principle of efficient debt management that was the original intent in setting up the FFB.

The Administration supports the basic intent of this bill, with some important reservations about (1) the technical attribution of FFB-financed activities in the budget and (2) the types of debt obligations that should be covered by this bill. We believe these issues can be resolved and we are working closely with Congress in resolving them. We are, for example, working with Senator Trible on the companion bill to H.R. 4629, S. 2213, the "Honest Budgeting Act of 1984". We are delighted to work with this committee in the same spirit of accomplishing our mutual goal of improved budgeting for Federal credit programs.

Administration Initiatives on Federal Credit

As I said last fall in my testimony on S. 1679, the "Honest Budgeting Act of 1983", a major priority of this Administration has been greater control over Federal credit activity. H.R. 4629 would make a major contribution toward this goal by encouraging comparison of outlays financed by FFB with other direct loan outlays, and with other types of outlays incurred for Federal programs.

The Administration made two significant proposals in the 1985 budget that are consistent with the intent of H.R. 4629, and that indicate the Administration's support for efficient debt management and improved credit policy. The first proposal would shift the direct loans for the foreign military sales credit program from the FFB to an on-budget account. By making this change, the budget would reflect more accurately the entire military aid financing program, part of which is already on budget. Under the Administration's proposal the foreign military sales credit program would be financed by Congressional appropriations for direct lending.

The second proposal would re-institute long-term financing of public housing projects through the FFB. Although the entire debt service of these projects is paid by the Federal Government, since 1974 these projects have been financed mostly with 100% federally guaranteed short-term tax-exempt instruments. Limited appropriations were provided in 1980 and 1981 to support sales of the obligations to the FFB. The Administration proposes to continue financing through the FFB in 1985, thereby strengthening the Treasury's debt management capability, eliminating the tax expenditure, and reducing the inefficiency arising from this method of financing. The proposal to put these fully guaranteed securities through the FFB demonstrates the need for legislation similar to H.R. 4629. Greater use of the FFB makes it imperative that we have improved reporting of its transactions in the budget.

I would emphasize that placing FFB outlays on-budget does not solve the problem of control over credit, nor does it address the issue of how credit programs ought to be operated. The credit budget should be strengthened by including it in the congressional budget process. The credit budget measures the total amount of new Federal credit activity -- both direct loan obligations and guaranteed loan commitments -- in contrast to the net outlays recorded on- and off-budget for direct loans. The credit budget and the related limitations placed on direct loan obligations and guaranteed loan commitments in appropriations bills are an essential part of our budget process.

On the subject of credit program operations, we are revising OMB Circular A-70, Federal Credit Policy, which will provide central guidance for credit programs. The circular will specify, among other things, the principles that determine minimum interest rates for new direct loan obligations, the minimum levels of guarantee fees, and the appropriate degrees of co-insurance. In a similar manner, many of the Reform 88 initiatives on credit management and credit standards will improve the administration of Federal credit programs.

Growth of Federal Credit Activity

I now want to discuss the problem of growth in Federal credit. Between 1979 and 1983, total direct loans and guaranteed loans outstanding increased by 69%, from $348 billion to $587 billion. Between 1975 and 1983, as Table 1 shows, disbursements for new direct loans increased from $28.8 billion to $50.5 billion, and new guaranteed loans increased from $41.3 billion to $78.0 billion. In 1983, Federal and federally assisted borrowing was $281 billion, or 56% of all funds borrowed by nonfinancial sectors in U.S. credit markets. This is the highest Federal borrowing participation ratio in U.S. credit markets since World War II and is a large increase since the first half of the 1970's, when Federal and federally assisted borrowing averaged $32 billion per year, and was 21% of all borrowing. The participation ratio has increased substantially since 1975, as Table 2 shows.

Table 1
DIRECT AND GUARANTEED LOAN DISBURSEMENTS, REPAYMENTS AND NET CHANGE, 1975-1985
(dollars in billions)

	Actual					Estimates	
	1975	1980	1981	1982	1983	1984	1985
On-budget Direct Loans							
Disbursements	20.8	37.8	39.6	33.9	41.0	41.4	35.3
Repayments	-15.0	-28.3	-34.4	-24.8	-36.2	45.3	-32.8
Net Outlays	5.8	9.5	5.2	9.1	4.8	-3.9	2.5
Off-budget Direct Loans							
Disbursements	8.0	23.6	31.5	14.8	9.5	12.3	9.6
Repayments	-1.0	-8.9	-10.6	-0.5	+1.0	+0.9	+0.9
Net Outlays	7.0	14.7	20.9	14.3	10.5	13.2	10.5
Guaranteed Loans							
New loans guaranteed	41.3	66.2	60.2	85.8	78.0	87.6	95.3
Repayments	-32.7	-34.6	-32.2	-64.9	-43.9	-48.2	-56.4
Net Change	8.6	31.6	28.0	20.9	34.1	39.4	38.9

Table 2
FEDERAL PARTICIPATION IN DOMESTIC CREDIT MARKETS
(dollars in billions)

	Actual					Estimates	
	1975	1980	1981	1982	1983	1984	1985
Net direct loan outlays: 1/							
On-budget	5.8	9.5	5.2	9.1	4.8	-3.9	2.5
Off-budget	7.0	14.7	20.9	14.3	10.5	13.2	10.5
Total direct loan outlays	12.8	24.2	26.1	23.4	15.3	9.3	13.0
Guaranteed loans	8.6	31.6	28.0	20.9	34.1	39.4	38.9
Government-sponsored enterprise loans	5.6	24.1	32.4	43.3	37.1	39.8	42.9
Total, Federal and federally assisted lending	27.0	79.9	86.5	87.6	86.5	88.5	94.8
Total funds advanced in U.S. credit markets2/	178.0	356.4	414.3	394.2	497.5	N/A	N/A
Federal lending participation ratio (%)	15.2	22.4	20.9	22.2	17.4	N/A	N/A
Federal borrowing from the public	50.9	70.5	79.3	135.0	212.3	183.0	193.0
Borrowing for guaranteed loans	8.6	31.6	28.0	20.9	34.1	39.4	38.9
Government-sponsored enterprise borrowing	5.3	21.4	34.8	43.8	34.6	39.8	42.4
Total, Federal and federally assisted borrowing	64.8	123.5	142.1	199.7	281.0	262.2	274.3
Total funds raised in U.S. credit markets2/	178.0	356.4	414.3	394.2	497.5	N/A	N/A
Federal borrowing participation ratio (%)	36.4	34.7	34.3	50.7	56.5	N/A	N/A

1/ Direct loans, guaranteed loans, and Government-sponsored enterprises are measured on a net basis (disbursements less repayments).
2/ Actuals from Federal Reserve Board Flow of Funds Accounts. Nonfinancial sectors, excluding equities.
Source: Special Analysis F of the U.S. Budget, Fiscal Year 1985.

The growth of agency programs financed by the FFB has been a major contributor to the increase in Federal credit programs. In 1983, the FFB outlays amounted to 68% of net Federal direct loan outlays. It is crucial that this large, and largely hidden, use of Federal credit be controlled effectively in order to encourage strong future growth in the economy.

Size and Growth of FFB Spending

The problem of control posed by the present budgetary treatment of programs financed by the FFB applies to a large volume of Federal activity. As shown in the following table, FFB outlays more than tripled from $6.4 billion in 1975, the FFB's first full year of operation, to $21.0 billion in the peak year of 1981. They have since declined, but they are still substantial. The February budget estimates that FFB outlays will remain in the $10 to $13 billion range in 1984 and 1985.

Table 3
OFF-BUDGET OUTLAYS
(in billions of dollars)

Fiscal Year	FFB	Other	FFB as a Percent of Total
1974.....	$ 0.1	$ 1.3	7%
1975.....	6.4	1.7	79
1976.....	5.9	1.4	80
TQ.....	2.6	-0.8	144
1977.....	8.2	0.5	94
1978.....	10.6	-0.3	102
1979.....	13.2	-0.7	106
1980.....	14.5	-0.3	102
1981.....	21.0	-*	100
1982.....	14.1	3.2	82
1983.....	10.4	2.0	84
1984 est.....	12.7	3.5	79
1985 est.....	10.2	4.6	69

As the preceding table shows, FFB outlays comprise most of the off-budget outlays of the Federal Government. The problem of off-budget outlays is thus primarily a problem of the budgetary treatment of programs financed by the FFB. (The U.S. Postal Service and the Strategic Petroleum Reserve comprise most of the off-budget outlays in the "other" category.) Under our February 1984 budget estimates, we project FFB outlays to decline significantly after 1985 primarily due to the proposal to shift the foreign military sales credit program from FFB financing to on-budget direct loans:

Table 4
ESTIMATED FFB OUTLAYS
(in billions of dollars)

1984.....	$12.7
1985.....	10.2
1986.....	6.9
1987.....	4.4

Achieving these reductions in off-budget outlays will be difficult. One major reason is that, as discussed above, the off-budget FFB outlays are not subject to the same budgetary review and control they would be if they were counted in the budget totals and charged to the agencies that are responsible for them. Another reason is that the projected reductions depend largely on enacting the legislation proposed for the foreign military sales credit program.

The FFB's financing of Government programs is concentrated in a few agencies. As shown below, in 1983 the Farmers Home Administration, the Rural Electrification Administration, and the foreign military sales credit program accounted for almost 90% of all FFB outlays.

Table 5
MAJOR USERS OF THE FFB
(in billions of dollars)

	Actual	Estimates	
	1983	1984	1985
Farmers Home Administration.....	$ 3.0	4.4	2.6
Rural Electrification Administration.....	3.0	4.0	3.6
Foreign military sales credit.....	2.9	3.6	2.0
Alternative fuels production.....	0.5	0.5	0.2
Low-rent public housing.....	0.4	0.2	1.2
Other.....	0.6	*	0.6
Total.....	10.4	12.7	10.2

Note: Although it is proposed that new direct loan obligations of the foreign military sales credit program be reflected on-budget in 1985, some net FFB outlays will be incurred in 1985 as the result of prior year obligations. If the proposal is not enacted, FFB outlays will be higher in 1985 and subsequent years than shown here.

In the past decade, Federal credit activity has expanded rapidly through on- and off-budget direct loans, loan guarantees, and Government-sponsored enterprise lending. Federally subsidized credit changes the allocation of credit from what would otherwise be provided in credit markets and causes distortions in resource allocation and the loss of economic efficiency. OMB conservatively estimates that subsidies arising from 1983 direct loan obligations alone totaled $8.4 billion. The costs of such activity must be

weighed against the public benefits of credit programs. In order to obtain accurate accounting of the costs of Federal credit programs, we need to include all direct lending in the budget. This step is not only more truthful in the sense of being more consistent and uniform, but it also permits more effective scrutiny of Government lending.

Budget Concepts

The Report of the President's Commission on Budget Concepts in 1967 is the foundation for the unified Federal budget. To gain budgetary control over the receipts and spending of the Government, the budget should include all of the Government's receipts and spending transactions. This requires that cash flows must be measured for all uses. The present use of the FFB is the greatest evasion of the cash flow concept of the unified budget.

The key improvement that we could make to the unified budget process is, therefore, to attribute the cash outlays of the FFB to the responsible agencies and programs in the unified budget. The overall budget totals would then measure more accurately the true size of Government outlays and the Government deficit. Attribution of the FFB's outlays to each responsible agency would improve control over the allocation of credit resources among different uses, agency-by-agency and function-by-function. Alternative programs cannot be compared with each other unless they are measured in the same accounting system. Failure to correct the current treatment of FFB activity will continue the distortions, abuses, and lack of control over Federal lending that have plagued sound budget management for years.

Coverage of H.R. 4629

For all of the above reasons, the Administration supports the basic intent of H.R. 4629. However, we recommend some amendments to improve the manner in which the bill works toward our mutual goals. Section 2 of H.R. 4629, as written, provides that "amounts of loans guaranteed or loan assets sold, by a Federal agency, which are financed by the Bank shall be recorded in the agency's budget as outlays", and that "budget authority used by the Bank for such transactions shall be attributed to the Federal agency". While the Administration has no serious substantive problems with this section, there are some technical concerns.

First, the language is somewhat vague because it omits any guidance for the manner of attributing or recording budget authority and outlays. Further, Section 2(c)(2), is inconsistent with Section 2(c)(1), by requiring only that "receipts from, and disbursements to, the Bank" shall be recorded in the unified budget for off-budget entities. This section does not provide that budget authority shall also be attributed on-budget. The Administration believes that budget authority as well as outlays should be included on-budget. We have drafted language for Section 2 that we believe is clearer and will submit that language in a separate report.

I would note that under H.R. 4629, the budget would include the interest received by FFB from agencies or the public, the interest paid by FFB to Treasury for its borrowings, FFB's administrative costs, and payments of surplus income by FFB to the general fund of Treasury. These residual payments and receipts would comprise an on-budget FFB account, since the requirement of

putting FFB off-budget has been removed. Under current practice the net amount of these outlays is approximately zero.

As written, Section 3 of H.R. 4629 states that Federal agencies may not issue, sell, or guarantee obligations "of a type" ordinarily financed in investment securities markets, unless these obligations are first offered for sale to the FFB. However, the bill would permit agencies that financed obligations in the investment securities market during fiscal year 1983 to continue their practice. We are satisfied that the provision would succeed in requiring new programs to use FFB, and that it would prevent existing programs from altering the terms and conditions of their financial instruments to avoid using the FFB. However, there remains the problem of existing programs that do not now use the FFB, but should. Enabling these agencies to avoid using the FFB is counter to our mutual goals of sound Federal credit policy and efficient debt management.

Not every loan guarantee program should use the FFB. Some loan guarantee programs are best served by private financial markets, and requiring these loan guarantee programs to be served by the FFB would disrupt private financial markets. A case in point is the Government National Mortgage Association (GNMA). The Administration has no intention of requiring GNMA securities to be purchased by the FFB. The Administration has therefore proposed a waiver mechanism to be administered by the Treasury Department that would provide the flexibility needed to avoid disruption of efficient private financial markets and ensure sound Federal credit policy.

Finally, Section 3 would exempt obligations not backed by the full faith and credit of the United States from the requirement to first offer such obligations to the Bank. TVA's bonds and its guarantees of loans to the Seven States Energy Corporation are the most notable examples. While the Administration fully intends that TVA's obligations will be exempted, we believe that such exemptions should be provided under the general waiver procedure established by Section 3, not under a specific provision of the law. This alternative would permit the flexibility to make decisions about other obligations not backed by the full faith and credit of the United States, that exist now or might be created in the future, without having to amend the statutes.

Conclusions

H.R. 4629 would require that the transactions of the Federal Financing Bank be included in the Federal budget and attributed to the agencies that are responsible for them. Such requirements are consistent with the budget concepts and concerns that I have just described. The basic intent of H.R. 4629 is important, and we support that intent. We therefore would welcome the opportunity to work with your Committee on the technical amendments necessary to achieve the principles of H.R. 4629 in the most effective way.

34-607 O—84——3

Mr. GIBBONS. Mr. Gradison.

Mr. GRADISON. Mr. Chairman, I just want to thank Mr. Wright for his testimony and indicate that I am satisfied that the questions which he raised are important and that they can be worked out, and look forward to working with representatives of the administration to see if these technical but very important matters can be resolved promptly.

Mr. GIBBONS. Mr. Pease.

Mr. PEASE. I have nothing right now, Mr. Chairman.

Mr. GIBBONS. Perhaps we had better hear from Mr. Healey next, and then we will ask questions.

STATEMENT OF THOMAS J. HEALEY, ASSISTANT SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

Mr. HEALEY. Good morning, Mr. Chairman and members of the committee. It is a pleasure to both have Paul Volcker's position in the Treasury some years later, and be supportive and encouraging of his good work, having been the godfather of the Federal Financing Bank.

Mr. GIBBONS. I hope we will remember you as favorably as we have remembered him.

Mr. HEALEY. Well, if I could do anywhere near as effective a job as he did, I maybe will merit that.

I welcome the opportunity to present the administration's view on H.R. 4629 which would require certain programs to be financed through the Federal Financing Bank and to be included in the Federal budget.

We strongly support the budget and debt management purposes of this legislation. On May 12 last year, Deputy Secretary McMamar presented to this committee a detailed statement of administration support for the basic purposes of legislation similar to 4629. He advised the committee that the administration had conducted an extensive review of the FFB in the broader context of overall administration budget and credit program policies.

That review led to the adoption of two important principles. First, that the administration supports a consolidated cash budget; and second, that the administration has concluded that over time, all Federal debt operations should be consolidated within the FFB.

While FFB outlays are now reported in the President's budget and are viewed by the administration as part of the total deficit, they are not included in the unified budget, and thus are not subject to the same budget appropriations discipline that is applied to other Federal outlays. It is much better policy that the unified budget should include all of the outlays by the FFB.

Furthermore, all agencies should, over time, be required to finance fully guaranteed obligations through the FFB, rather than in the securities markets. The FFB was established in 1973 to deal with what were then severe debt management problems resulting from years of off-budget financing which had flooded the Government securities market with a variety of Government-backed securities.

The FFB has helped curb the growth of Government guarantees by eliminating the profit incentive of investment bankers and pri-

vate institutions which previously had benefited from inefficient financing of guaranteed securities directly in the market. Even the investment banking industry, my former industry, testified in favor of the establishment of the FFB in 1973, apparently recognizing that financial markets generally would benefit more if the Government got its financing house in order.

The proliferation of Government-backed securities in the market prior to the FFB establishment was very costly to the Government, in part because of the high transaction costs and in part because of the less competitive market for these securities. For example, prior to the establishment of the FFB, fully guaranteed obligations of the Department of Defense under the foreign military sales program were financed in the open market with interest rates as much as two percentage points higher than the prevailing Treasury yields for securities of comparable maturity.

Since there is no economic difference between a guaranteed loan on the one hand and direct loan by the FFB, or any other Federal agency, there seems to be no reason to incur these higher costs to the Government for financing guarantee programs in the private markets.

Now, there still seems to be in the minds of some a persistent myth that guaranteed loans are substantially different from direct loans and involve less Government intervention in the traditional borrower/lender relations. This is not so. For both direct and guaranteed loans, the Government assumes all the credit risks. Direct loans are financed by Treasury issues sold to the same private investor groups that acquire U.S. guaranteed obligations. Further, FFB financing of the guarantees results not only in no increase in the Federal Government's contingent liability on these guarantees, but even some minor decrease in the liability because of their reduced interest cost.

After a decade of successful operations, it is widely recognized that the FFB has accomplished its stated purpose, assuring coordination of federally assisted borrowing programs and reducing the cost of Federal and federally assisted borrowings from the public.

The consolidation of $136 billion of market financing into the FFB has resulted in an estimated savings in program financing costs of well in excess of a half a billion dollars each year, most of which savings go to the Government rather than the guaranteed borrowers. The FFB accomplishes this task with only 12 full-time employees, probably the most efficient bank in the world.

However, the FFB's task is not yet completed. The title XI bonds guaranteed by the Maritime Administration continue to be financed in the securities market, even though they have 100 percent guarantees. There is an AID guarantee program, and a portion of the HUD public housing program of tax exempt securities, both of which have 100-percent guarantees, yet are financed in the market. FFB financing of these programs would result in further substantial savings to the U.S. taxpayer.

The FFB Act was essentially a debt management reform, and not a budget reform, as the Chairman has mentio ed. The FFB Act did not change the budget treatment of the prog ams financed by the FFB. While the FFB's primary function is debt management, the FFB has succeeded in highlighting the need for control of Federal

credit programs by consolidating the borrowing of the various agencies. The FFB has made the control problem more visible, as indicated by the purpose of this hearing today.

Turning to the specifics of 4629, we strongly support both the budget and debt management purposes of the bill. Our principal concern with 4629 in its present form is that it would permit certain agencies to bypass the FFB in order to avoid being included in the budget. The administration would strongly oppose attempts to limit or do away with program use of the FFB in order to avoid having budget outlays attributed to that program in the unified budget. Avoidance of the FFB in this manner would lead to both higher debt management costs and also to a budget that underreported the credit activities of the U.S. Government.

The amendments to section 7 of the FFB Act proposed in the current draft of 4629 which would allow agencies to bypass the FFB would not be in accord with the President's program. Attached to my prepared statement is a proposed amendment which would correct these deficiencies.

In concluding my remarks, I would just like to reiterate the strong support for the basic purposes of the bill and to offer to look forward to working with the committee and staff to clarify the language, especially in section 3, and resolve any remaining differences.

[The prepared statement follows:]

Statement of Thomas J. Healey, Assistant Secretary of the Treasury (Domestic Finance)

Mr. Chairman and Members of the Committee:

I welcome this opportunity to present the Administration's views on H.R. 4629, a bill to require certain programs to be financed through the Federal Financing Bank and to be included in the Federal budget. The Administration strongly supports both the budget and debt management purposes of this legislation.

On May 12, 1983 Deputy Secretary McNamar presented to this Committee a detailed statement of Administration support for the basic purposes of legislation similar to H.R. 4629. Deputy Secretary McNamar advised the Committee that the Administration had conducted an extensive review of FFB in the broader context of overall Administration budget and credit program policies. That review led to the adoption of two important principles. First, the Administration supports a consolidated cash budget; and second, the Administration has concluded that, over time, all Federal debt operations should be consolidated within the Treasury Department and FFB. While FFB outlays are now reported in the President's Budget and are viewed by the Administration as

part of the total deficit, they are not included in the unified budget and are thus not subject to the same budget-appropriations discipline that is applied to other Federal outlays. It is better policy that the unified budget should include all of the Government's cash outlays to the public, including outlays to the public by FFB and all agencies should, over time, be required to finance fully guaranteed obligations through FFB rather than in the securities markets.

FFB was established by the Federal Financing Bank Act of 1973, at the request of the Treasury, to deal with severe debt management problems resulting from years of off-budget financing which had flooded the Government securities market with a variety of Government-backed securities. These securities were financed outside the Treasury by various Federal agencies in the form of direct agency issues, sales of loan assets, and guarantees of obligations of private borrowers. Although the securities were backed by the Government they sold at relatively high interest rates and fees, they competed with Treasury securities, undermined Treasury debt management policies, created serious marketing problems, and placed Treasury in a position of being required to sanction or approve agency financings on terms which Treasury believed did not reflect the full value of the Government backing.

The proliferation of Government-backed securities in the market before the FFB was established was very costly to the Government, in part because of higher transaction costs and in part because the less competitive market for the securities resulted in higher

profits to investors and investment bankers. For example, prior to the establishment of the FFB, obligations fully guaranteed by the Department of Defense under the foreign military sales program were financed in the securities markets at interest rates up to 2 percentage points over prevailing market yields on Treasury securities of comparable maturity. Since there is no economic difference between a guaranteed loan and a direct loan by FFB or another Federal agency, there is no reason to incur higher costs to the Government for financing guarantee programs in the private markets.

The FFB Act was essentially a debt management reform, not a budget reform. That is, the FFB is authorized to purchase any obligation issued, sold, or guaranteed by any Federal agency and thus to consolidate the financing of both budget and off-budget programs and reduce the costs of financing these programs. The FFB Act did not change the budget treatment of the programs financed by the FFB.

FFB was a response to a need to control and rationalize financing of Federal programs, primarily credit assistance programs. This need arose from three basic trends: (1) the rapid growth of Federal credit assistance programs; (2) the shift from direct loans (on-budget) to Government guaranteed loans (off-budget); and (3) the shift from Government guaranteed loans financed by local lending institutions to Government guaranteed obligations financed

directly in the securities markets. These trends have continued and have contributed to the explosive growth of Federal guarantee programs which has occurred in recent years.

While the myth seems to persist that guaranteed loans are substantially different from direct loans and involve less Government intervention in traditional borrower-lender relationships, this is not so. A guaranteed loan may be termed a direct Government loan when FFB provides the financing but this characterization only obscures the underlying issue. For both direct and guaranteed loans, the Government assumes the credit risk and private investors are the ultimate lenders. Direct loans are financed by Treasury issues of U.S. obligations to the same private investor groups that acquire U.S. guaranteed obligations. FFB does not increase the amount of financing coming to market; it only accomplishes the task more efficiently. Nor does FFB financing of guarantees result in any increase in the Federal Government's contingent liability on these guarantees. In fact, the contingent liability is reduced since, in the event of any default, the guarantor agency will be liable for interest at a lesser rate (the FFB rate) than a private lender would charge.

Now, after a decade of successful operations, it is widely recognized that the FFB has accomplished the stated purpose of the Federal Financing Bank Act of 1973 -- to assure coordination of federally assisted borrowing programs, to reduce the costs of Federal and federally assisted borrowings from the public, and to assure that

such borrowings are financed in a manner least disruptive of private financial markets and institutions.

Thirty Federal agency programs of issues, sales or guarantees of securities, totaling about $136 billion of obligations currently outstanding (see attached table), have been financed by the FFB rather than in the securities markets. The consolidation of market financing by the FFB has resulted in estimated savings in program financing costs of well in excess of $1/2 billion a year, most of which are savings to the Government rather than to guaranteed borrowers. The FFB accomplishes this task with only 12 full-time employees, and the FFB has eliminated the need to have separate debt management staffs with securities market expertise in the various agencies financed by the FFB.

The FFB's task is not yet completed, however. The Merchant Marine Bonds guaranteed by the Maritime Administration under Title XI of the Merchant Marine Act continue to be financed in the securities market with 100 percent guarantees; the AID housing guarantees and a portion of the HUD public housing program of 100 percent guarantees of tax-exempt securities are also financed in the market. FFB financing of these programs would result in further substantial savings to the U.S. taxpayer.

While the FFB's primary function is debt management, FFB has also served to facilitate the control of Federal credit programs. By consolidating the borrowing of various agencies, FFB has made the problem of unrestrained growth in Federal credit more visible

and has underscored the need for more effective control. The extraordinary growth of loan guarantee programs is attributable to the erroneous view that meeting growing constituent demands for Federal assistance could be accomplished without pain or cost through the provision of off-budget loan guarantees and agency sales of loan assets on a recourse basis. These programs would have grown as much or possibly even more without FFB, because they would have been financed off-budget directly in the Government-guaranteed securities market (at a greater direct cost to the Government), as they were before the FFB was established. Also, the FFB has served to bring to the attention of Congress the true nature and aggregate impact of these programs and has led to many important investigations and studies, including this hearing, which hopefully will in turn result in greater restraints on the future growth of these programs.

It should be recognized that a major stimulus to the growth of loan guarantee programs is the profit incentive of investment bankers and related private institutions to finance them in the market. FFB eliminates this incentive and, in this way, acts to curb the growth of guarantees. Prior to the establishment of FFB, there was a very strong profit incentive for the investment banking industry to promote the growth of guarantee programs, and to take initiatives to establish new programs, since such guarantees would shift the financing from commercial banks to the securities market and provide new sources of income for investment banking services, such as financial advisory fees and underwriting profits.

Yet, while investment bankers realize substantially less profits from trading in the Treasury securities issued to finance FFB than they did from marketing new issues of obligations guaranteed by other Federal agencies, even the investment banking industry testified in favor of the establishment of FFB in 1973, apparently recognizing that financial markets generally would benefit more if the Government got its financial house in order.

Turning now to the specifics of H.R. 4629, while we strongly support both the budget and debt management purposes of the bill, our principal concern with H.R. 4629 in its present form is that it would permit certain agencies to by-pass the FFB in order to avoid being included in the budget. The Administration would strongly oppose attempts to limit or avoid program use of the FFB in order to avoid the attribution of outlays, budget authority or other budgetary resources to that program in the unified budget. Avoidance of the FFB in this manner would lead both to higher debt management costs and to a unified Federal budget that underreported the credit activities of the U.S. Government. Amendments to section 7 of the FFB Act, such as proposed in H.R. 4629, that could allow agencies to by-pass the FFB in order to avoid the attribution of the credit activities in the unified budget would not be in accord with the President's program.

Proposed Administration Amendment to H.R. 4629

Section 2 of H.R. 4629 deals with the budget treatment of the activities financed by the FFB. The purpose of section 2

is to assure that all agency activities financed by the FFB are included in the unified budget and attributed to the user agencies. We strongly support this purpose. OMB Deputy Director Wright's testimony discusses the provisions of section 2, and I will discuss the debt management provisions of section 3.

As mentioned earlier, the Administration has adopted the principle that any obligation which is issued, sold, or guaranteed by a Federal agency and is backed by the full faith and credit of the United States should be financed by FFB rather than in the securities market. Section 3 of H.R. 4629 would take a limited step toward assuring this result by amending section 7 of the FFB Act to establish a presumption that programs now using the FFB, new programs, and revised programs be financed by the FFB. However, section 3 would provide an exemption from the requirement for FFB financing for programs or parts of programs which were not financed by the FFB during fiscal year 1983. We must oppose this exemption.

A Federal guarantee creates an instrument that is the credit-risk equivalent of a Treasury security. Yet guaranteed obligations are sold in the market at yield premiums over Treasury securities as a result of their relative trading illiquidity, smaller size of issues, and discrete terms that distinguish them from Treasury issues and each other. Recent market issues of securities fully guaranteed by the Maritime Administration, for example, have been priced at 1/2 to 1 percentage point in yield above Treasury securities of comparable maturity. Also, tax-exempt public housing notes guaranteed by HUD are now financed in the market at a significant

cost to the Government, both from the tax losses and the greater transaction and financing costs from this less efficient marketing technique. Clearly, each of these programs should be financed through FFB, at significantly less cost to the Federal Government. Moreover, the Administration recently proposed legislation to remove a statutory impediment to FFB financing of certain obligations fully guaranteed by the Agency for International Development. Accordingly, enactment of an exemption for programs not now financed by the FFB would not be in accord with the program of the President.

Section 3 also provides that an exception to the presumption for FFB financing could be granted if the program agency is able to demonstrate, to the satisfaction of the Secretary of the Treasury, (1) lower costs from private financing as compared to financing by the Bank, (2) services to borrowers from private markets or institutions which outweigh added costs of private financing, or (3) undue disruption of existing financial markets due to financing by the Bank.

With respect to the first criterion, we are not aware of any circumstances under which market financing would be cheaper than FFB financing, and we see no need for this provision.

With regard to the second criterion -- services to borrowers from private markets or institutions -- we agree that "real" guarantee programs, that is, programs involving meaningful participation by private lenders by sharing credit risks or performing useful loan servicing functions, such as required for the small and administratively cumbersome FHA and VA mortgages and guaranteed

student loans, should not be financed by the FFB.

Similarly, with respect to the third criterion -- undue disruption of existing financial markets -- we recognize that certain guarantee programs may at times be financed in large established markets through complex and highly developed institutional arrangements to an extent that shifting such financing to the FFB would be unduly disruptive. Our recommended language, which is attached to this statement, is broad enough to encompass concerns addressed by the bill and yet would not establish an unnecessary statutory appeal and reporting procedure as would H.R. 4629. The amendment we propose is designed to exempt "real" guarantees from the requirement for FFB financing, and provides authority to waive the requirement with respect to situations where FFB financing would unduly disrupt existing financial markets, such as the market for GNMA mortgage-backed securities.

We have no objection to the amendment proposed in section 3 of H.R. 4629 that would exempt from the presumption of FFB financing obligations "issued or sold by a Federal agency pursuant to an Act of Congress which expressly prohibits any guarantee of such obligation by the United States" or "funds disbursed pursuant to an agreement backed by the assets of such agency". An effect of this language would be to exempt debt and guarantees issued by the Tennessee Valley Authority from the presumption for FFB financing. Since TVA debt and guarantees are not backed by the full faith and credit of the United States, these obligations should be financed

in the market and not by the FFB. Yet, an early proposal by this Administration that TVA borrow in the market, rather than from the FFB, was strongly resisted by the Congress.

I would like to reiterate our strong support for the basic purposes of H.R. 4629, and I look forward to working with the Committee to resolve our remaining differences.

That concludes my prepared statement, Mr. Chairman. I will be happy to respond to your questions.

Attachments

Administration Proposed Amendment to Section 3 of H.R. 4629

Delete lines 8 through 25 on page 2 and lines 1 through 18 on page 3, and inserted in lieu thereof:

(a) Section 7 of the Federal Financing Bank Act is amended by adding at the end thereof the following:

"(d) A Federal agency other than the Department of the Treasury may not issue, sell, or guarantee an obligation of a type which is ordinarily financed in investment securities markets, as determined by the Secretary of the Treasury, unless the terms of the obligation provide that it may not be held by any person or entity other than the Bank or another Federal agency. The Secretary of the Treasury may waive this requirement with respect to obligations that the Secretary determines are (1) not suitable investments for the Bank because of the risks entailed in such obligations or (2) financed in a manner that is least disruptive of private financial markets and institutions. The Secretary of the Treasury shall issue regulations to carry out the provisions of this subsection, and such regulations shall list the types of obligations that are subject to the requirement in the first sentence of this subsection."

Delete subsection (b) and redesignate subsection (c) as subsection (b).

FEDERAL FINANCING BANK HOLDINGS
(in millions)

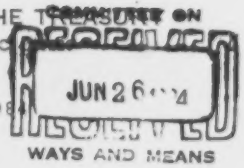
Program	February 29, 1984	January 31, 1984	Net Change 2/1/84-2/29/84	Net Change--FY 1984 10/1/83-2/29/84
On-Budget Agency Debt				
Tennessee Valley Authority	$ 13,150.0	$ 13,255.0	$ -105.0	$ 35.0
Export-Import Bank	14,788.6	14,788.6	-0-	112.7
NCUA-Central Liquidity Facility	33.5	33.7	-0.3	-10.9
Off-Budget Agency Debt				
U.S. Postal Service	1,154.0	1,154.0	-0-	-0-
U.S. Railway Association	110.9	110.9	-0-	-13.9
Agency Assets				
Farmers Home Administration	54,471.0	54,776.0	-305.0	-2,220.0
DHHS-Health Maintenance Org.	119.5	119.5	-0-	0.7
DHHS-Medical Facilities	143.8	143.8	-0-	0.1
Overseas Private Investment Corp.	13.1	13.1	-0-	-3.2
Rural Electrification Admin.-CBO	3,467.5	3,467.5	-0-	-0-
Small Business Administration	44.9	45.8	-0.9	-3.6
Government-Guaranteed Lending				
DOD-Foreign Military Sales	15,623.9	15,431.3	192.6	1,330.6
DED.-Student Loan Marketing Assn.	5,000.0	5,000.0	-0-	-0-
DOE-Geothermal Loans Guarantees	-0-	-0-	-0-	-45.0
DOE-Non-Nuclear Act (Great Plains)	1,086.5	1,060.0	26.5	201.0
DHUD-Community Dev. Block Grant	199.0	193.7	5.3	21.7
DHUD-New Communities	33.5	33.5	-0-	-0-
DHUD-Public Housing Notes	2,178.5	2,178.5	-0-	111.7
General Services Administration	415.4	415.4	-0-	-1.8
DOI-Guam Power Authority	36.0	36.0	-0-	-0-
DOI-Virgin Islands	28.8	28.8	-0-	-0.3
NASA-Space Communications Co.	869.0	859.3	9.7	-78.2
DON-Defense Production Act	1.8	1.6	0.2	0.7
Rural Electrification Admin.	19,982.4	19,927.3	55.1	1,043.5
SBA-Small Business Investment Cos.	840.3	822.4	17.9	36.0
SBA-State/Local Development Cos.	222.7	206.9	15.8	74.9
TVA-Seven States Energy Corp.	1,503.8	1,482.2	21.6	85.4
DOT-Amtrak	-0-	-0-	-0-	-880.0
DOT-Section 511	163.7	178.4	-14.7	-19.9
DOT-WMATA	177.0	177.0	-0-	-0-
TOTALS*	$ 135,859.0	$ 135,940.2	-$ 81.2	-$ 222.8

*figures may not total due to rounding

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

June 25, 1984



Dear Mr. Chairman:

The Department would like to take this opportunity to comment on the testimony provided by two private witnesses at the April 4, 1984 hearing before your Committee on H.R. 4629, the "Truth-In-Budgeting Act of 1984".

The representative of the Mortgage Bankers Association of America urged the Committee to amend the bill to make clear that the Government National Mortgage Association mortgage-backed security program, "as it now is and as it may develop over time," will be exempt from the requirement in the bill that guaranteed obligations ordinarily financed in the investment securities market be sold to the Federal Financing Bank.

We would not object to an explicit exemption from FFB financing for the current GNMA guarantees of mortgage-backed passthrough securities. However, we are concerned about how the program may change over time. Recent developments in the private market suggest that there may well be pressures to create a more marketable GNMA instrument, conceivably with semiannual interest payments and principal paid only at maturity. Such an instrument would, in effect, be a Treasury security by another name. The earliest issues of GNMAs were of this bond type. Thus, any explicit exemption should refer only to the current GNMA guarantees of mortgage-backed passthrough securities.

The representative of the National Rural Electric Cooperative Association offered an interpretation that section 4 of the bill would permit rural electric and telephone cooperatives to use either the FFB or the securities markets for financing REA guaranteed loans. Thus, this interpretation would effectively exempt REA guaranteed obligations from the requirement in the bill for FFB financing. We would oppose section 4 unless it were made clear that section 4 merely preserves the existing statutory right for the rural cooperatives to use the FFB.

Sincerely,

Thomas J. Healey

Thomas J. Healey
Assistant Secretary
(Domestic Finance)

The Honorable
Dan Rostenkowski, Chairman
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

34-607 O—84——5

Mr. GIBBONS. Thank you, Mr. Healey.

Now, Mr. Gradison, you are recognized.

Mr. GRADISON. Thank you, Mr. Chairman.

Thank you very much for your testimony, Mr. Healey. Am I correct that if the proposed amendment which is attached to your statement were included in a revision of this bill, that 4629, as then amended, would be satisfactory to the Treasury? Are there any other changes, or is this it?

Mr. HEALEY. From the Treasury point of view, that is it.

I think that OMB has some specific questions on some of the budgetary language that they want to work with you on, but that is the basic objection.

Mr. GRADISON. Thank you very much.

Thank you, Mr. Chairman.

Mr. GIBBONS. Mr. Pease.

Mr. PEASE. No, thank you, Mr. Chairman.

Mr. GIBBONS. OMB, do you want to tell us what you have that you think we need, in addition to what we have already talked about?

Mr. WRIGHT. Mr. Chairman, I mentioned very briefly, I think, that one area on the manner of attributing or recording budget authority and outlays to the agencies' budgets—we would just like to see that clarified. That is section 2(c)(2).

Mr. GIBBONS. I wonder if you could help the committee by submitting some language to us?

Mr. WRIGHT. We will be happy to.

Mr. GIBBONS. It would be appreciated.

Mr. WRIGHT. Also, Mr. Chairman, I believe we have a technical problem, in that section 2(c)(2) is inconsistent with section 2(c)(1) before it, and we would be happy to work with you on that one.

Mr. GIBBONS. All right, sir. Thank you very much, gentlemen.

Mr. WRIGHT. Thank you.

Mr. GIBBONS. Our next witness is from the Congressional Budget Office, Dr. Rudolph G. Penner, the Director. And I would say, Dr. Penner, it is a pleasure to welcome you here. It is the first time I have had an opportunity to officially welcome you to the Ways and Means Committee.

I think the Congressional Budget Office has done a fine job, and Dr. Rivlin set a fine example. I hear that you are doing a good job, too, so we welcome you here.

STATEMENT OF RUDOLPH G. PENNER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. PENNER. Thank you very much, Mr. Chairman, for those kind words.

I am pleased to appear before this committee to testify in support of the Truth in Budgeting Act of 1984—that is, H.R. 4629—the bill introduced by Congressman Gradison to correct the budget treatment of activities financed by the Federal Financing Bank [FFB]. The Congressional Budget Office [CBO] has been concerned about the current treatment of the FFB for some time.[1] My prede-

[1] Congressional Budget Office, "The Federal Financing Bank and the Budgetary Treatment of Federal Credit Activities," January 1982.

cessor, Alice Rivlin, testified before this committee last May and described the FFB's budget treatment and the related problems in some detail. Since that statement is part of your record, I will limit my comments this morning to a summary of the major budget issues presented by the FFB and the solution provided by the Truth in Budgeting Act.

BUDGET ISSUES RAISED BY THE BUDGET TREATMENT OF THE FFB

Under current practices, FFB operations contribute to a situation in which the unified budget deficit understates Federal borrowing requirements and otherwise identical loans appear to have different budgetary costs. During fiscal year 1984, CBO estimates that the FFB will add $12.3 billion to total Federal borrowing requirements. If current policies are continued, the FFB will add more than $76 billion to our borrowing requirements over the next 5 years. By 1989, the FFB would account for over $180 billion of the public debt subject to limit. None of these funds will appear in the Federal deficit, but all will become part of the debt. The deficit is now stimulating an intense fiscal policy debate, but the most commonly used measure—the unified budget deficit—understates the Government's borrowing needs. Moreover, agencies' additional off-budget borrowing requirements add confusion to the debate over the debt ceiling bill. Most of that confusion would be eliminated by moving the FFB transactions on-budget.

The Federal Financing Bank purchases of Farmers Home Administration and Rural Electrification Administration [REA] loan assets shift loans from the agencies' books to the FFB. The FFB's financing of guarantees—primarily for the REA and foreign military sales credit programs—converts loans authorized by the Congress as guaranteed loans into direct loans of the Government—albeit off-budget loans. Both the loan asset purchases of the FFB and its financing of guarantees enable agencies to lend without having to request budget authority. The agencies therefore avoid the scrutiny of both the budget and the appropriations processes. If financing by the FFB makes it easier for agencies to attain a higher loan level, it affects the allocation of the Federal resources.

THE TRUTH IN BUDGETING ACT OF 1984

The Truth in Budgeting Act of 1984 corrects the problems presented by the budgetary treatment of the FFB by amending the Federal Financing Bank Act of 1973. It requires the transactions of the FFB to be reflected in the unified budget. The Federal budget would, therefore, reflect more accurately the fiscal operations of the Federal Government. The act requires the transactions of the FFB to be recorded in the originating agencies' budgets, thereby ensuring that all agency transactions are taken into consideration as budget resources are allocated.

In order to ensure that agencies currently receiving the advantages of FFB financing could not bypass the FFB and return to the securities markets to avoid budgetary controls, the Truth in Budgeting Act requires that all activities financed through the Bank during fiscal year 1983 remain in the Bank thereafter. Thus, when the new accounting provisions take effect, these activities would be

fully and correctly recorded in the budget. Activities financed in the investment securities markets during fiscal year 1983 could continue to be financed outside the FFB. New programs that would otherwise be financed in the investment securities markets are required first to offer their obligations to the FFB. The agency can finance its obligations in the investment securities markets if it can demonstrate to the Secretary of the Treasury that program purposes would be better served by such financing. These provisions insure that Federal programs will be financed in the most efficient manner and displayed clearly in the unified budget.

ACHIEVING A COMPREHENSIVE BUDGET

Two weeks ago, I presented to the Senate Banking Committee a report entitled "New Approaches to the Budgetary Treatment of Federal Credit Assistance." That report explores options for improving the quality of budget data for credit and for facilitating cost comparisons among credit programs and between credit and direct spending. Two major problems in current treatment are identified: the lack of comprehensiveness of the budget and the inadequacy of net lending as a measure of the economic impact of credit programs. The paper suggests four, not mutually exclusive, accounting and operating changes that would correct in whole or in part current exclusions and other misstatements of Federal credit cost. The first reform measure described in the paper is the FFB plan—the proposal embodied in the Truth in Budgeting Act of 1984—which corrects the understatement of lending and borrowing resulting from the off-budget status of the FFB. The paper then suggests three alternative approaches to correcting the misstatement of Federal credit cost. It concludes that the FFB activities should be on-budget, regardless of what action is taken on the other reforms. The three alternatives we have suggested for improving credit cost measures will require the careful scrutiny of the Congress before a consensus can be established for a favored approach.

The principal participants in the budget process, however, widely support including FFB activites in the budget. The budget resolution for 1984 expressed the sense of the Congress that this issue be addressed. The Bielenson task force report proposes language that would implement this change. The Truth in Budgeting Act of 1984 is a carefully crafted approached to making the budget more comprehensive. I support its enactment.

Thank you very much, Mr. Chairman.

Mr. GIBBONS. Thank you, sir.

Mr. Gradison.

Mr. GRADISON. Thank you, Mr. Chairman.

I want to thank Mr. Penner for his testimony and in particular for the leadership which the Congressional Budget Office has shown in the development of some highly original research on this general subject.

In a very real sense, what we are talking about today is a smaller part of a much bigger issue, and the references which you made to the presentation to the Senate Banking Committee 2 weeks ago indicate the broad breadth, the vision of the CBO in trying to think

through with Congress proper directions for future accounting and budgetary treatment of Federal lending programs.

So I just want to say thank you very much. Keep up the good work.

Mr. PENNER. Thank you, Congressman.

Mr. GIBBONS. Mr. Pease.

Mr. PEASE. Thank you, Mr. Chairman. I have no questions. I would like to commend Mr. Penner for his testimony also and say that I join my colleague, Mr. Gradison, in commending CBO for its work. I think we are making progress in having a more rational budget process than we have had before.

It is a little difficult to prove that point, looking at the size of the deficits, but I try to tell my constituents that the deficits would be even worse, were it not for the structure that we have in place and for the independence and the excellence of the CBO in helping us carry that out.

And so I commend you for your testimony.

Mr. PENNER. Thank you very much, Congressman.

Mr. GIBBONS. Mr. Schulze.

Mr. SCHULZE. I have no questions, Mr. Chairman.

Mr. GIBBONS. Mr. Duncan.

Mr. DUNCAN. I have just one.

What would the implementation of your recommendations do for the activities of the various organizations that are using the Federal Financing Bank now? Are you going to make changes abruptly or phase them in over a period of time?

Mr. PENNER. What we would do, sir, or what is normally done under these circumstances is to adjust the historical record to reflect the new practice. So as a particular agency's activity was better reflected in the budget, it would not appear as though that agency had suddenly expanded. Rather, you would have the whole record going back a number of years, and you could compare it—compare apples and apples, as it were, compare their new level of activity to their old level of activity.

Mr. DUNCAN. Thank you.

Mr. GIBBONS. I think you have raised a very fine point there, Mr. Duncan.

Dr. Penner, I noticed a group of young people in here a while ago, listening very intently to the witnesses, and I am sure they found this subject just as dull as anything they have ever heard, but I think if they had understood the significance of it, they would not find it dull.

What we are really debating, as I see it, is how we allocate costs. It appears to me that what we have been real good at doing during my generation is passing on a hell of a lot of cost to those young people. Now, maybe I have got a warped opinion of it, but that seems to me to be what we are doing. And I think in all fairness to them and fairness to ourselves, we ought to allocate these costs a little more intelligently than we have done, and as I see what Mr. Gradison's legislation is doing, is making us face up to that problem.

Have you thought about it in that light, or have you thought about it in those terms?

Mr. PENNER. I think you have put it very well, sir. That is exactly what it does. It puts these costs on the table the way they should be put in the accounting sense.

Now, in terms of controlling the costs better and having a better basis for comparing one program to another, and for comparing lending to direct spending, then I think the Congress should at least consider going further and looking at the various options that we analyzed in the other study that Mr. Gradison referred to.

But certainly this legislation would be a big step forward. The other options in no way interfere with taking this step. If we took this step, there would at least be a correspondence between what is called the deficit in the press and among the public and the true financing needs of the Government. That correspondence does not exist under the present rules.

Mr. GIBBONS. It seems to me we have been, because of failure to account—and this is a part of it—trying to enjoy many things today and are leaving to someone else the responsibility of paying for them later. I may be wrong in that observation, but I just have the feeling that that is what is happening, and I worry about the size of the pay-later bill that we are leaving to other generations when I look at the demographics of this country and things of that sort.

Mr. PENNER. Well, I would wholeheartedly support your observations, sir. I think they are exactly right.

Mr. GIBBONS. Thank you, Dr. Penner.

Our next group of witnesses is a panel from the Mortgage Bankers Association of America, Mr. James A. Abbott, who is the vice chairman of the legislative committee—he is the president of Cameron-Brown Co. of Charlotte, N.C.; the National Housing Conference, Mr. Carl Coan, who is the legislative counsel; and Salomon Brothers, Inc., Mr. Miner H. Warner, vice president and manager of the Government Finance Group.

If that panel would come forward, we would be delighted to hear you. Mr. Abbott, you seem to be the first one there, and I guess we have one witness missing, it looks like. Is Mr. Coan here?

[No response.]

Mr. GIBBONS. All right. Well, Mr. Abbott, you are first. Go right ahead, sir.

STATEMENT OF JAMES A. ABBOTT, VICE CHAIRMAN, LEGISLATIVE COMMITTEE, MORTGAGE BANKERS ASSOCIATION OF AMERICA, AND PRESIDENT, CAMERON-BROWN CO., ACCOMPANIED BY BURTON C. WOOD, LEGISLATIVE COUNSEL, AND WILLIAM E. CUMBERLAND, GENERAL COUNSEL, MORTGAGE BANKERS ASSOCIATION OF AMERICA

Mr. ABBOTT. Thank you, Mr. Chairman and members of the committee. My name is Jim Abbott. I am president and chief executive officer of Cameron-Brown Co., a mortgage banking firm located in Charlotte, N.C. I am testifying today in my capacity as vice chairman of the legislative committee of the Mortgage Bankers Association of America.

Accompanying me today are Burton C. Wood, MBA's legislative counsel, and William E. Cumberland, MBA's general counsel.

We appreciate the opportunity to appear before you today to testify regarding H.R. 4629, the Truth in Budgeting Act of 1984. If enacted, this legislation would subject all Federal agency guarantees of obligations of the type ordinarily financed in the investment securities markets to the jurisdiction of the Federal Financing Bank, unless otherwise exempted by the bill.

MBA is concerned that the exemption, as presently set forth in H.R. 4629 is not adequate to prevent mortgage-backed securities guaranteed by the Government National Mortgage Association from being included in the jurisdiction of the FFB, and therefore, MBA urges the committee to amend H.R. 4629 to make clear that the GNMA mortgage-backed security program, as it now is and as it may develop over time, will not be subject to the jurisdiction of the FFB.

The GNMA mortgage-backed security program involves mortgages insured by the Federal Housing Administration and guaranteed by the Veterans' Administration. Under the MBS program, lenders package FHA and VA mortgages into "pools," issue securities backed by the pools, and sell them in the capital markets to permanent investors. GNMA prescribes a standard format for the securities and guarantees the performance of the originator/issuer, who must pay investors principal and interest due each month, regardless of whether all funds have been received from borrowers. Although the GNMA–MBS is a guarantee program, in the 13 years of its existence, its fee income has always offset its expenses. The GNMA–MBS program has successfully allowed homebuyers to tap the Nation's capital markets to finance the purchase of their homes.

It is our understanding that the sponsor of the bill, Mr. Gradison, and the sponsor of similar legislation in the Senate, Senator Paul Trible, did not intend H.R. 4629 and S. 2213, the companion bill, to require that the GNMA mortgage-backed security program use the FFB. In recent weeks, their staff and the staff of MBA have been discussing clarifying amendments. We are hopeful that a satisfactory legislative solution will emerge.

The GNMA mortgage-backed security program, which is more fully described in our written statement, is not a program that is suited for the FFB.

First, and perhaps most important, the initial marketing of GNMA mortgage-backed securities is conducted by private lenders. There is a highly sophisticated liquid market which operates to assure that the initial offerings can be placed in the national capital market at the most accurate and lowest market price. A facilitator such as the FFB is not only unnecessary, but would increase administrative costs and could interfere with the timely flow of capital. Rather than increase efficiency, the facilitator would decrease it.

Second, the cash flow and other financial characteristics of the GNMA mortgage-backed securities differ from debt instruments issued by Federal agencies because a portion of the principal is repaid each month.

Third, GNMA does not use its guarantee in the mortgage-backed security program to finance outlays by GNMA. The funds lent in connection with the GNMA MBS program are from private lenders

to private borrowers, and are expected to be repaid by the private borrowers.

In conclusion, MBA believes that the GNMA mortgage-backed security program works sufficiently and successfully to support home ownership, that to include the GNMA-MBS program in the FFB would be a mistake, and that H.R. 4629 should be amended to make it clear that the GNMA-MBS program is not intended to be included in the FFB.

MBA respectfully urges the committee to make such amendments. We appreciate the opportunity to appear before the committee today, and would be happy to answer any questions you may have.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF JAMES A. ABBOTT, PRESIDENT, CAMERON-BROWN CO., CHARLOTTE, N.C., ON BEHALF OF THE MORTGAGE BANKERS ASSOCIATION OF AMERICA

Mr. Chairman and Members of the Committee, my name is James A. Abbott. I am President and Chief Executive Officer of Cameron-Brown Company, a mortgage banking firm located in Charlotte, North Carolina. I am testifying today in my capacity as Vice Chairman of the Legislative Committee of the Mortgage Bankers Association of America.* MBA is the trade association of the Nation's mortgage banking and real estate finance industries. Accompanying me today are Burton C. Wood, MBA's Legislative Counsel, and William E. Cumberland, MBA's General Counsel.

We appreciate the opportunity to appear before you today to testify regarding HR 4629, the "Truth-in-Budgeting Act of 1984." If enacted, this legislation would subject all Federal Agency guaranties of obligations of the type ordinarily financed in the investment securities markets to the jurisdiction of the Federal Financing Bank (FFB), unless otherwise exempted by the bill. MBA is concerned that the exemption is not adequate to prevent mortgage-backed securities guaranteed by the Government National Mortgage Association (GNMA) from being included in the jurisdiction of the FFB, and, therefore, MBA urges the Committee to amend HR 4629 to make clear that the GNMA mortgage-backed security (MBS) program, as it now is and as it may develop over time, will not be subject to the jurisdiction of the FFB.

---

*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgages and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- o Mortgage Banking Companies
- o Mortgage Insurance Companies
- o Life Insurance Companies
- o Commercial Banks
- o Mutual Savings Banks
- o Savings and Loan Associations
- o Mortgage Brokers
- o Title Companies
- o State Housing Agencies
- o Investment Bankers
- o Real Estate Investment Trusts

MBA headquarters is located at 1125 15th Street, N.W., Washington, D.C. 20005; telephone: (202) 861-6500

Efforts to Clarify the Coverage of HR 4629

It is our understanding that the sponsor of the bill, Mr. Gradison, and the sponsor of similar legislation in the Senate, Senator Paul Trible, did not intend HR 4629 and S 2213, the companion bill, to require that the GNMA-MBS program use the FFB. In recent weeks their staff and the staff of MBA have been discussing clarifying amendments. We are hopeful that a satisfactory legislative solution will emerge.

The Federal Financing Bank

As envisioned by the Federal Financing Bank Act of 1973 (PL 93-224), the FFB serves as a facilitator for Federal Agencies that would otherwise finance their operations and programs by issuing Agency debt obligations and selling them in the capital markets. It was not intended to be a policeman, but rather to offer Federal Agencies the opportunity to obtain funds more efficiently without facing the vagaries of the investment securities market, sometimes in competition with one another.

Apparently, a current budgetary effect of the FFB is that certain Agencies fund some of their outlays using the FFB and thereby do not recognize those outlays in the Agency's budget. As we understand the purpose of HR 4629, the bill is intended to require Agencies using the FFB to show the FFB-financed outlays as part of the Agency's budget. To MBA's knowledge, GNMA has never used the FFB, so it would seem that the GNMA program would be unrelated to the purpose of the bill.

However, the drafters of HR 4629 were apparently concerned that some Agencies might decrease their use of the FFB in favor of going direct to the capital markets in the future.

In response to this concern, the bill requires that after September 30, 1984, a Federal Agency may not issue, sell, or guarantee any obligation of a type ordinarily financed in the investment securities markets without submitting to the jurisdiction of the FFB and the Secretary of Treasury, who is also the Chairman of the Board of the FFB. In recognition that certain programs currently being conducted by the Federal government involve the Federal issuance, sale, or guaranty of investment securities, but are inappropriate for the FFB, the bill provides an exemption from the Bank's jurisdiction.

Inclusion of GNMA is Not Appropriate

The GNMA-MBS program, which is more fully described later in this statement, is not a program that is suited for the FFB. First, and perhaps most important, the initial marketing of GNMA-MBSs is conducted by the private lenders who originate the mortgages backing the securites. There is a highly sophisticated, liquid market, which operates to assure that the initial offerings can be placed in the national capital markets at the most accurate, and lowest, market price. A "facilitator," such as the FFB, is not only unnecessary, but would increase administrative costs and could interfere with the timely flow of capital. Rather than increase efficiency, the "facilitator" would decrease it.

Second, the cash flow and other financial characteristics of GNMA-MBSs differ from debt instruments issued by Federal Agencies, because a portion of the principal is repaid each month. For this reason, the GNMA-MBS would not fit into the FFB in an efficient manner.

Third, GNMA does not use its guaranty in the MBS program to finance outlays by GNMA. The funds lent in connection with the GNMA-MBS program are from private lenders to private borrowers and are expected to be repaid by the private borrowers. The GNMA-MBS program is an actuarially sound, user-fee supported program. It is not the type of Agency activity the "Truth-in-Budgeting Act of 1984" is designed to address.

The Exemption Provisions of the Bill

The exemption provisions in HR 4629 are contained in Section 3, as follows:

> "(a)(1)(A) A Federal Agency that issued, sold, or guaranteed obligations financed in investment securities markets after September 30, 1982, and before October 1, 1983, may continue financing such obligations, or other obligations serving the same program purposes, up to the percentage of its annual activities obligated or disbursed during fiscal year 1983 in investment securities markets at the discretion of that Federal Agency."

The intent of the "percentage of its activities obligated or disbursed" limit is not clear. It would perhaps make sense applied to an Agency financing itself partly by appropriations and partly by Agency debt. In this context, a Congressional reduction in appropriations would automatically restrict debt financed activity proportionately.

However, as applied to GNMA, the coverage does not fit. The ratio of the dollar volume of the GNMA-MBS program to the dollar volume of GNMA's other activities is around 25:1 with the other activities, such as the Federal Asset Liquidation Trust and Federal Activities Financing Trust activities, and the sale of multifamily mortgages, scheduled to be reduced drastically. The leveraged effect on GNMA-MBSs would be fatal.

Furthermore, GNMA is a constituent part of the Department of Housing and Urban Development (HUD) and the term "Federal Agency" could be interpreted to be HUD, which is apparently headed for reduced appropriations financed activities as well.

The additional language "at the discretion of that Federal Agency, " would subject GNMA-MBS to whatever limitation the Administration might wish to impose. In other words, impoundment. Congress has repeatedly passed legislation that requires the President to allow use of GNMA's guaranty authority to the extent that private market demand calls for it; that the program ceilings established by Congress have not been reached; and that the program applicants are qualified. This language could be interpreted to supercede the anti-impoundment legislation.

Government National Mortgage Association

The Federal government, long ago, recognized the social need for, and importance of, housing its citizens, and responded in an appropriate manner by creating programs to fulfill this social goal. One significant housing program is the GNMA-MBS program. Not only has the GNMA-MBS program worked efficiently by not incurring any costs that drained revenues, but it has been profitable and has achieved a remarkable success in structuring a mortgage finance delivery system that provides readily available sources of mortgage credit throughout all phases of interest rate cycles, and involves private sector lenders and investors to a maximum degree.

GNMA was established in 1968, and its mortgage-backed security program was initiated soon thereafter to introduce alternative sources of capital investment into the secondary mortgage markets. Lenders increasingly have sold loans through the secondary market to

permanent investors, rather than holding the mortgages themselves as long-term portfolio investments. This allows lenders in credit short areas to sell their loans in the long-term capital markets, so that the lenders can reinvest their limited capital in additional local mortgages. Mortgage finance now depends upon accessibility to an efficient nationwide secondary market. The GNMA-MBS program has helped to foster the secondary mortgage market and to mobilize money on a nationwide basis. This program has served to help stabilize the mortgage finance market throughout economic cycles, as well as to create a truly nationwide secondary market.

The creation of the GNMA-MBS revolutionized mortgage finance by providing a highly liquid, securitized instrument, which attracted traditional and non-traditional investors alike. The GNMA-MBS program involves mortgages insured by the Federal Housing Administration (FHA) and guaranteed by the Veterans Administration (VA), but not conventional loans. Under the MBS program, lenders package FHA/VA mortgages into "pools," issue securities backed by the pools, and sell them in the capital markets to permanent investors. GNMA prescribes a standard format for the securities and guarantees the performance of the originator/issuer, who must pay investors principal and interest due each month, regardless of whether all funds have been received from borrowers. Although the GNMA-MBS is a guaranty program, in the 13 years of its existence, its fee income has always offset its expenses. It has not cost the government a single penny because all of its expenses are paid by those who use the program. Additionally, it is a secondary guaranty program. That is, losses in the GNMA program would only be incurred to the extent that the FHA insurance and the VA guaranty on the loans packaged in GNMA-MBSs exceeded the FHA or VA coverage.

The benefit enjoyed under these programs is not a subsidy, but the capital market efficiency of the GNMA security. The GNMA-MBS program ensures lenders of ready

placement in the secondary market for FHA and VA loans. In effect, the existence of the GNMA-MBS program allows the individual moderate- and middle-income consumer the same access to credit markets as large corporate borrowers.

The future of the mortgage finance delivery system is heavily clouded by uncertainty. The thrift industry continues to undergo major changes which could undermine its future capacity to provide long-term financing for homebuyers. Fundamental changes in the powers of all financial institutions are presently being debated in Congress, and those changes could alter the roles of many institutions that previously have been deeply involved in mortgage finance. As the role of these traditional mortgage finance institutions as a predominant source of mortgage credit is altered, the pivotal importance of the secondary mortgage market will increase, because of its ability to attract supplies of mortgage credit from non-traditional, as well as traditional investors. A lender, rather than having to procure an investor for every individual loan, now packages a number of loans in a mortgage pool, which is a more efficient process and less costly than the sale of individual loans. Investors need not consider the merits of the individual loans themselves, or even know the specific features of the mortgages, but can rely instead on the proven track record of the GNMA security.

The GNMA-MBS is one of the most significant and successful mechanisms ever derived for attracting capital for mortgage investments. MBA believes that the continued strength of the GNMA-MBS program will assist the development of a viable conventional MBS market, because trading the GNMA-MBSs serves to establish a benchmark for the pricing of these instruments, as well as serving as a model for the development of a conventional MBSs in a market that is currently undergoing radical changes.

In summary, the GNMA-MBS guaranty program was created to facilitate the function of the FHA and VA programs, which assure access to the credit markets in support of homeownership. These programs are remarkably successful at achieving these goals, at no cost to the Treasury. However, the task is not yet finished. The 1980s represent a clear challenge to the housing and mortgage finance industries to deliver adequate supplies of affordable mortgage credit to unprecedented numbers of potential homeowners. The GNMA-MBS program will help to address those needs efficiently, unless its operation is restricted. It is our considered judgment that inclusion of GNMA-MBSs in the Federal Financing Bank (FFB) would, indeed, prove a serious impediment to the future success of the GNMA-MBS program.

Conclusion

In conclusion, MBA believes that the GNMA-MBS program works efficiently and successfully to support homeownership; that to include the GNMA-MBS program in the FFB would be a mistake; and that HR 4629 should be amended to make it clear that the GNMA-MBS program is not intended to be included in the FFB. MBA respectfully urges the Committee to make such amendments.

MBA appreciates the opportunity to appear before the Committee today and would be happy to answer any questions or provide additional material you may request.

Mr. GIBBONS. Warner, you may proceed.

STATEMENT OF MINER H. WARNER, VICE PRESIDENT AND MANAGER, GOVERNMENT FINANCE GROUP, SALOMON BROS., INC.

Mr. WARNER. My name is Miner Warner.

Mr. GIBBONS. You are going to have to get closer to that mike, Mr. Warner. We are going to buy some good ones one of these days.

Mr. WARNER. My name is Miner Warner. I am with the investment bank of Salomon Brothers. I have been involved with Federal credit programs since 1971, which actually predates the FFB, Federal Financing Bank, and I am familiar with the guarantees and assets which are sold within the FFB and also outside.

We certainly favor the objectives of H.R. 4629 because that would have the consequence of putting the financing activities of FFB on-budget and also curtailing under the current draft of your bill FFB's persistent and ongoing efforts to increase its funding of guarantees which have been financed successfully outside the bank.

We believe that putting FFB on-budget would be a major step towards greater budgetary accuracy and reporting, and also would serve to discourge certain accounting practices and distortions which are encouraged by FFB being off-budget today.

In addition, putting FFB on-budget would subject the activities of FFB to far greater scrutiny and also to improved congressional oversight. Guarantee programs which have been characterized by defaults and subsequent conversions to grants such as, for example, foreign military sales, have been financed through FFB and, by the way, could not be financed in the private sector.

Unusual and favorable financing terms have sometimes been obtainable by some borrowers from FFB and not others. In any event, this has all taken place without scrutiny.

In summary fashion, I would like to indicate how FFB was intended to act, how it never acted the way it was intended to act, how it has been costly to the Treasury Department, and also typically to guaranteed borrowers which have had access to it.

When FFB was established, pursuant to the FFB Act of 1973, it was planned to be a stand-alone agency; that is, one which would be acting as a central financing conduit for the Federal agencies and would also be funding itself. After an initial issuance of short-term bills in 1974, the FFB ceased to finance in the public markets, and FFB began funding through Treasury. So it was a question of Treasury financing through Treasury, and that in our view has been the genesis of the problem.

Had there been market scrutiny, it is, in our view, highly unlikely that the mismatch of assets and liabilities would have been permitted to take place.

In the course of this talk, I would like to mention a couple of myths as I see them, which relate to FFB and FFB practice. One myth has been that, prior to the creation of FFB, there was a great deal of private sector financing of guaranteed borrowers in the private sector. In point of fact, there was only a modest volume of guaranteed borrowing prior to the creation of FFB. Guaranteed borrowing is really a phenomenon which developed in size after FFB.

In terms of today's borrowing, by the way, the amounts borrowed then outside the Treasury were modest, which is perhaps an unfortunate commentary. Much of the borrowing which took place prior to the creation of FFB was quasi-Federal agencies. Then, as now, quasi-Federal agencies finance outside the Bank and are the second largest borrowing group next to the Treasury in our capital markets.

I might add that only one quasi-Federal agency continues to finance inside the Bank—the Tennessee Valley Authority. The other quasi-Federal agency, SLMA, the Student Loan Marketing Association, left the Bank in 1981. So in point of fact, there was only really a very, very modest volume of guaranteed financing done before the Bank was created, and guarantees have really been a phenomenon which has developed in great size since the creation of FFB.

It is true, however, that full faith and credit agencies which used to finance independently now finance through the Bank.

Now, I think that Dr. Penner has already noted that the effect of FFB funding of a guarantee is to convert a contingent guarantee to a direct outlay through a loan. That loan, of course, has to be financed. That is financed by Treasury on a rollover basis. The result of that is that the volume of Treasury debt has been heedlessly swollen by such guarantee conversions to direct loans.

I think it can be seriously questioned whether this was the intent of Congress, as it is reasonable to suppose that had that been so, why then Congress would have directed that these be direct loan programs to start with. The effect of this guarantee conversion to a direct loan has contained, in essence, a double subsidy: The use of Federal credit through the full faith and credit guarantee, without which a borrower could not possibly access the capital market, and second, the borrower has obtained a market rate subsidy—that is to say, the difference between the one-eighth over Treasury's which FFB charges and, say, a market rate, for illustration purposes, three-quarters of 1 percent.

One has to raise the question why this double subsidy for guaranteed borrowers. Also, perhaps it is not so well-known when FFB first commenced operations in the 6- and 7-percent rate environment in 1974, the spread over which FFB was charging guaranteed borrowers was three-eights of 1 percent and that was reduced to one-eight of 1 percent. Again, why?

I would note here, and it is appended to my testimony, a very interesting extract from the OMB debt collection project, published in January 1981, which reviews FFB activities.

Well, I have tried to review briefly the history of the FFB. Let me go on and touch on two other areas. One is why, in my view, the evolution should not have been satisfactory to Treasury, and second, why this evolution has not been satisfactory to guaranteed borrowers.

FFB is run like the largest and most old-fashioned thrift in the United States, along pre-October 1979 lines. That means that it lends long and it borrows short. It has a mismatched loan book. The result, therefore, is that FFB has assumed the funding and market risk. Again, one is compelled to ask why. Why take on this risk?

Before the Senate Budget Committee in 1982, I testified that based on conservative calculations in fiscal year 1981, this mismatched loan book had cost Treasury $1.4 billion. We estimate that there were comparable results in the 1982 fiscal year. I do not have statistics to make the calculations for fiscal year 1983, but I would be delighted subsequently to submit to this committee, if asked for.

Going on, the myth persists, that there is no difference between a contingent liability and a direct outlay. We have discussed that. But another is that guaranteed debt and Treasury debt are sold to one and the same investors. That could not be further from the truth, and that is self-evident because the yield on a guaranteed obligation is virtually always higher than on a Treasury. Why would that be so if they are exactly the same;

It is simple. The answer is they are not the Treasury market represents the largest, most liquid, and the most risk-free market in the free world. Guaranteed debt, by contrast, is fragmented, has limited liquidity, and fungibility. That is to say, that a guarantee under title XI is not the same as the title of an AID Office of Housing guarantee, two programs mentioned earlier. They have different provisions in the event of a default, and most importantly, there is always the risk that the guaranteed borrower will either default or prepay.

By definition, investors in guaranteed debt have different investment criteria than investors in Treasury debt. That is just a given. And there are two consequences of FFB's activity which we would think would be adverse to Treasury's interest. One has an impact on the cost of financing the national debt, and the other has an impact on State and local revenues. The interest rate on Treasury debt is the yardstick for all debt in the United States. It is the yardstick for mortgages; it is the yardstick for the capital markets; everything is priced in relationship to Treasury debt.

By contrast, agency debt which is enormous, and guaranteed debt which is less substantial, financed in the private sector, is a pricing benchmark for nothing. In our view, in the absence of a substantially changed portion of financing, that is, substantially more agency and guaranteed debt, agency and guaranteed debt will continue not to play the yardstick role which the Treasury debt plays and will continue to play.

In terms of State and local tax revenues, it should be noted that guaranteed debt is subject to State and local taxation. FFB, by converting these guarantees to direct loans, and Treasury then issuing direct Treasuries to finance those loans, sterilizes the tax base on these guarantees. A guarantee financed through FFB is no longer subject to State and local taxation. Tens of billions of dollars have been removed, therefore, if you will, from State and local tax rolls.

My third and final point is that FFB by no means has been an unmitigated blessing to borrowers. It is true that on any given day, that FFB, by definition, at one-eighth over will typically represent the cheapest source of funds that a borrower could take, but there are some adverse consequences here also. Note that FFB serves no oversight function, and I hasten to add that it has no mandate to do so.

FFB currently completely fulfills the mandate that it has, but its mandate is very limited and very passive. Its mandate and its sole

mandate is to make funds available in any authorized maturity at any point in time upon the request of an eligible borrower. As a result, there is no market oversight, and consequently there is the possibility and in some cases there has been the certainty of the encouragement of noncommercial transactions.

I mention FFB gives no market or interest rate advice at all. In addition, for all intents and purposes, prepayment or refinancing is precluded by FFB practice. As a practical consequence, therefore, a guaranteed borrower who finances through FFB gives up all financing flexibility which is very expensive.

Now, in terms of this due diligence or this oversight, bankers and lawyers, who of course charge fees in the marketplace, necessarily exert discipline over guaranteed borrowers in private-sector financing. Projections are scrutinized, and if the projections do not withstand that scrutiny, then some remedial action is required and is forced upon borrowers. FFB borrowers have told me in confidence that the automaticity of funds and the fact that funds are always available has contributed to hard decisions being postponed, projects continued far beyond any commercial justification, and of course, material losses generated through the absence of any meaningful oversight. Obviously, this is undesirable, and you will have more of this if there is expanded FFB financing.

Let me conclude by saying that the private sector in the financing of guarantees has contributed in a couple of meaningful ways. One has been interest rate advice and market sensitivity, because getting the interest right is key. That decides a lot about a project. And interest rates have been so volatile recently that interest rate advice and timing is very important. Second, as financial adviser, a major private sector oversight role has been played here, which has been useful.

And may I add once more that we favor very much the objectives of the bill before the committee today.

Mr. Chairman, this concludes the formal part of my testimony.

[The prepared statement follows:]

Statement of Miner H. Warner, Vice President and Manager, Government Finance Group, Salomon Bros., Inc.

MY NAME IS MINER H. WARNER, AND I AM VICE PRESIDENT AND MANAGER OF THE GOVERNMENT FINANCE GROUP AT THE INVESTMENT BANK OF SALOMON BROTHERS INC. I AM FAMILIAR WITH THE FEDERAL CREDIT PROGRAMS WHICH FINANCE BOTH OUTSIDE THE FEDERAL FINANCING BANK (FFB) AND THROUGH FFB AND HAVE ALSO ASSISTED IN THE NEGOTIATION OF GUARANTEES FUNDED THROUGH FFB. MY FAMILIARITY WITH FEDERAL CREDIT PROGRAMS DATES FROM 1971, WHICH PREDATES FFB, WHEN I WORKED WITH WILLIAM E. SIMON WHO WAS THEN IN CHARGE OF THE GOVERNMENT DEPARTMENT AT SALOMON BROTHERS PRIOR TO HIS APPOINTMENT AS SECRETARY OF THE TREASURY.

(1) WE FAVOR THE OBJECTIVES OF H.R. 4629, ENTITLED "TRUTH IN BUDGETING ACT OF 1984", WHICH WOULD HAVE AS A CONSEQUENCE (A) PUTTING THE FINANCING ACTIVITIES OF FFB ON BUDGET AND (B) CURTAILING THE FFB'S PERSISTENT AND ON-GOING EFFORTS TO INCREASE ITS FUNDING OF GUARANTEES WHICH HAVE BEEN FINANCED SUCCESSFULLY IN THE PRIVATE SECTOR.

FFB ON BUDGET WOULD BE A MAJOR STEP IN THE DIRECTION OF ACCURATE ACCOUNTING OF DIFFERENT AGENCY CREDIT USAGE. AT PRESENT, BY FFB BEING AN OFF-BUDGET AGENCY, THAT PART OF FFB'S LOANS WHICH FUND GUARANTEES OF OFF-BUDGET AGENCIES ARE NOT REPORTED, THEREBY UNDERSTATING THE FEDERAL DEFICIT. PUTTING FFB ON BUDGET WOULD ACT AS AN INCENTIVE TO CORRECT CERTAIN ACCOUNTING DISTORTIONS, FOR EXAMPLE, AGENCY ASSET SALES WHICH ARE MADE WITH CONTINUED RECOURSE TO THE SELLING AGENCY.

PUTTING FFB ON BUDGET WOULD ALSO FOCUS SCRUTINY ON FFB ACTIVITIES AND SUBSTANTIALLY ASSIST CONGRESSIONAL OVERSIGHT. FOR EXAMPLE, SOME GUARANTEE PROGRAMS, CHARACTERIZED BY DEFAULTS AND SUBSEQUENT CONVERSION TO GRANTS, SUCH AS FOREIGN MILITARY SALES GUARANTEES, ARE FINANCED THROUGH FFB. UNUSUAL AND FAVORABLE FINANCING TERMS ARE OFFERED BY FFB TO CERTAIN GUARANTEED BORROWERS AND NOT TO OTHERS -- ALL WITHOUT SCRUTINY.

IT IS MY INTENTION IN SUMMARY FASHION TO REVIEW THE HISTORY OF FFB, INDICATE HOW IT HAS NEVER ACTED AS IT WAS INTENDED TO ACT, AND HOW IT HAS BEEN COSTLY, BOTH TO THE TREASURY DEPARTMENT AND TYPICALLY TO GUARANTEED BORROWERS WHICH HAVE HAD ACCESS TO IT.

(2) WHEN FFB WAS ESTABLISHED IN 1974 IT WAS INTENDED TO ACT AS A CENTRAL BORROWING CONDUIT FOR FEDERAL AGENCIES WHICH HAD BEEN FINANCING IN THE PUBLIC MARKETS. AT THE SAME TIME, IT WAS INTENDED THAT FFB WOULD FUND ITSELF IN THE PUBLIC MARKET. INSTEAD, AFTER ONE ISSUE IT TURNED TO TREASURY, THAT IS TO SAY "DOWN THE CORRIDOR", FOR ALL ITS FINANCING, AND THEREIN LIES THE GENESIS OF THE PROBLEM. ONCE FFB BEGAN FUNDING THROUGH TREASURY, FFB WAS NO LONGER THE STAND-ALONE AGENCY WHICH WAS CONTEMPLATED BY THE FEDERAL FINANCING BANK ACT OF 1973, AND IT BECAME SOLELY A MATTER OF TREASURY DEALING WITH TREASURY AND HENCE CLOSED TO MARKET SCRUTINY.

HAD THERE BEEN SUCH MARKET SCRUTINY, IT IS HIGHLY UNLIKELY THAT FFB'S EXPENSIVE MISMATCH IN ASSETS AND LIABILITIES AND ASSUMPTION OF FUNDING RISK AS DISCUSSED LATER WOULD HAVE BEEN ACCEPTABLE.

A MYTH WHICH HAS BEEN WIDELY CIRCULATED IS THAT PRIOR TO THE CREATION OF FFB THERE WAS A GREAT DEAL OF PRIVATE SECTOR FINANCING OF GUARANTEED BORROWERS WHICH WAS DONE IN A CHAOTIC AND DISORDERLY FASHION.

ACTUALLY, THE GREAT BULK OF GUARANTEED DEBT DATES FROM AFTER THE CREATION OF FFB, PART OF WHICH HAS BEEN FINANCED IN THE PRIVATE SECTOR AND PART OF WHICH HAS BEEN FUNDED THROUGH FFB. THE LARGEST NON-HOUSING GUARANTEE PROGRAM, BACKED BY THE RURAL ELECTRIFICATION ADMINISTRATION, WAS CREATED AFTER FFB AND HAS BEEN FINANCED VIRTUALLY EXCLUSIVELY THROUGH FFB. THE BULK OF FEDERAL CREDIT BACKED SECURITIES FINANCED PRIOR TO FFB WAS NOT GUARANTEES BUT WAS QUASI-FEDERAL AGENCY DEBT, WHICH NOW AS THEN CONTINUES TO BE FINANCED IN THE PRIVATE SECTOR, AND A CERTAIN VOLUME OF "FULL FAITH AND CREDIT" AGENCY DEBT. PRIOR TO THE CREATION OF THE FEDERAL FARM CREDIT CONSOLIDATED SYSTEMWIDE BONDS (FARM CREDIT), THE THREE CONSTITUENT PARTS OF FARM CREDIT FINANCED SEPARATELY, NAMELY, FEDERAL LAND BANKS, FEDERAL INTERMEDIATE CREDIT BANKS, AND BANKS FOR COOPERATIVES, GIVING AN ILLUSION OF GREATER FINANCING ACTIVITY. OTHER QUASI-FEDERAL AGENCIES WERE REGULARLY PRESENT IN THE MARKETPLACE. OF THE "FULL FAITH AND CREDIT" AGENCIES, THERE WAS ONLY ONE MAJOR REGULAR ISSUER, EXPORT-IMPORT BANK OF THE UNITED STATES. TENNESSEE VALLEY AUTHORITY, A QUASI-FEDERAL AGENCY WHICH, UNLIKE STUDENT LOAN MARKETING ASSOCIATION (SALLIE MAE), CONTINUES TO FINANCE THROUGH FFB WAS ANOTHER REGULAR ISSUER. IN ADDITION,

THERE WAS ONE ISSUE FOR THE UNITED STATES POSTAL SERVICE, OCCASIONAL ISSUES BY GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GINNIE MAE) AND BY WASHINGTON METRO, SOME MODEST SIZED ISSUES FOR GENERAL SERVICES ADMINISTRATION (GSA) AND ONE SMALL ISSUE FOR SMALL BUSINESS ADMINISTRATION (SBA). THERE WERE A NUMBER OF MODEST ISSUES IN THE PRIVATE PLACEMENT MARKETS INCLUDING ISSUES FOR GSA, MILITARY SEALIFT COMMAND, AND SOME POORLY RECEIVED DEPARTMENT OF DEFENSE GUARANTEED ISSUES. FINALLY, THERE WERE SOME LARGE ASSET SALES BY FARMERS HOME ADMINISTRATION (FmHA). THE FmHA ASSET SALES WERE PART AND PARCEL OF ADMINISTRATION SUPPORTED "BUDGET GAMES" WHICH DATED FROM THE 1960'S.

VASTLY MORE AGENCY AND GUARANTEED FINANCING IS ACCOMPLISHED TODAY THROUGH THE PRIVATE SECTOR THAN WAS EVER RAISED PRIOR TO FFB. IT CLEARLY HAS NOT SERVED, AS CERTAIN OF ITS DEFENDERS MIGHT INACCURATELY SUGGEST, AS A CONDUIT FOR FEDERAL CREDIT COMING TO MARKET.

(3) THE EFFECT OF FFB FUNDING OF GUARANTEES HAS BEEN TO CONVERT A CONTINGENT LIABILITY, I.E., GUARANTEE, TO A DIRECT OUTLAY THROUGH A LOAN. THE VOLUME OF TREASURY DEBT HAS BEEN HEEDLESSLY SWOLLEN BY SUCH CONVERSIONS. IT CAN BE SERIOUSLY QUESTIONED WHETHER THIS WAS THE INTENT OF CONGRESS AS IT IS REASONABLE TO SUPPOSE THAT HAD THIS BEEN SO THEN CONGRESS WOULD HAVE PROVIDED FOR A DIRECT LOAN PROGRAM FOR QUALIFIED BORROWERS. IN FACT, GUARANTEED BORROWERS THROUGH FFB ARE PROVIDED WITH A DOUBLE SUBSIDY: (1) THE USE OF FEDERAL CREDIT THROUGH THE "FULL FAITH AND CREDIT" GUARANTEE, AND (2) A MARKET

RATE SUBSIDY WHICH IS THE DIFFERENCE BETWEEN FFB'S LENDING RATE OF TREASURIES PLUS 1/8 OF 1% AND THE MARKET'S RATE FOR GUARANTEED DEBT, FOR INSTANCE, AT TREASURIES PLUS 3/4 OF 1%. WHY THIS DOUBLE SUBSIDY?

IT SHOULD BE NOTED ALSO THAT TERMS OF FFB'S LOANS ARE SUBJECT TO THE SOLE DISCRETION OF FFB. FOR INSTANCE, WHEN FFB FIRST COMMENCED OPERATIONS IN A 6 AND 7% RATE ENVIRONMENT, IT CHARGED QUALIFIED BORROWERS 3/8 OF 1% OVER THE YIELD ON TREASURIES, BUT LATER IN THE 1970'S IT UNILATERALLY REDUCED THAT SPREAD FROM 3/8 TO 1/8 OF 1%. AGAIN, WHY?

BY THE WAY, THE OFFICE OF MANAGEMENT AND BUDGET PUBLISHED A PERCEPTIVE AND AUTHORITATIVE REVIEW OF FFB ACTIVITIES IN JANUARY 1981 AS PART OF THE OMB DEBT COLLECTION PROJECT: REPORT ON STRENGTHENING FEDERAL CREDIT MANAGEMENT. ATTACHED TO MY TESTIMONY ARE PAGES 62-76 FROM THE OMB REPORT.

(4) FFB HAS NOT EVOLVED IN A WAY WHICH SHOULD BE SATISFACTORY TO TREASURY.

FFB IS RUN LIKE THE LARGEST AND MOST OLD-FASHIONED THRIFT IN THE UNITED STATES ALONG PRE-OCTOBER 1979 LINES. IT LENDS LONG AND IT FINANCES SHORT AND, CONSEQUENTLY, RUNS A MISMATCHED LOAN BOOK. INDEED, IT CAN NEVER RUN A MATCHED BOOK AS BORROWERS UNDER CERTAIN PROGRAMS OBTAIN AUTHORIZED GUARANTEES WHICH ARE LONGER THAN THE 30 YEAR TREASURY BOND. WHAT FFB HAS DONE HAS BEEN TO ASSUME THE FUNDING RISK AND MARKET INVESTMENT RISK, I.E., HAS ACTED AS A PERMANENT

INVESTOR. AGAIN, ONE IS COMPELLED TO ASK WHY. WHY HAS FFB NEEDLESSLY ASSUMED THIS RISK? IN FISCAL YEAR 1981, WE ESTIMATED CONSERVATIVELY THAT THE FUNDING RISK WHICH FFB ASSUMED COST THE TREASURY $1.4 BILLION WITH COMPARABLE RESULTS IN FISCAL YEAR 1982. WE DO NOT HAVE INFORMATION IN HAND TO ESTIMATE THE COST OF FFB TO TREASURY FOR FISCAL YEAR 1983 BUT WOULD BE PLEASED TO SUBSEQUENTLY TRANSMIT SUCH CALCULATIONS TO THE COMMITTEE.

JUST AS THE MYTH PERSISTS THAT THERE IS NO DIFFERENCE BETWEEN A CONTINGENT LIABILITY AND A DIRECT OUTLAY, ANOTHER PERSISTENT AND PERNICIOUS MYTH HAS BEEN THAT GUARANTEED DEBT AND TREASURY DEBT ARE PURCHASED BY EXACTLY THE SAME INVESTORS AND THAT CONSEQUENTLY GUARANTEED DEBT IS SOMEHOW IN DIRECT COMPETITION WITH TREASURY DEBT. FROM A MARKET STANDPOINT, NOTHING COULD BE FURTHER FROM THE TRUTH. MOREOVER, THIS SHOULD BE OBVIOUS TO EVERYONE GIVEN THE FACT THAT GUARANTEED DEBT GENERALLY ALWAYS BEARS A HIGHER YIELD THAN TREASURY DEBT OF COMPARABLE MATURITY. THE TREASURY MARKETS ARE ENORMOUS, LIQUID, AND RISK FREE. THE GUARANTEED DEBT MARKETS ON BALANCE ARE FRAGMENTED INTO MANY DIFFERENT PROGRAMS, EACH WITH DIFFERENT PROVISIONS AND CONDITIONS, AND GUARANTEED DEBT HAS LIMITED LIQUIDITY, FUNGIBILITY, AND INVARIABLY INVESTMENT RISK, I.E., THERE IS ALWAYS A RISK THAT THE GUARANTEED BORROWER WILL DEFAULT OR PREPAY. BY DEFINITION, INVESTORS IN GUARANTEED DEBT HAVE DIFFERENT CRITERIA THAN INVESTORS IN TREASURY DEBT.

THERE ARE TWO OTHER CONSEQUENCES OF FFB'S ACTIVITIES WHICH ARE ADVERSE TO TREASURY AND WHICH HAVE A NEGATIVE IMPACT ON (A) THE COST OF THE NATIONAL DEBT AND, INDEED, THE CAPITAL MARKETS IN THE UNITED STATES, AND (B) ON STATE AND LOCAL TAX REVENUES.

(A) INTEREST RATES ON TREASURY DEBT THROUGHOUT ALL MATURITY SECTORS ARE THE YARDSTICK FOR ALL DEBT PRICING. ALL FINANCING IS ARRANGED AT YIELDS DIRECTLY RELATED TO THE YIELD ON TREASURY DEBT, THE PREMIER CREDIT IN THE MARKETPLACE. A GREATER VOLUME OF TREASURY FINANCING TYPICALLY SIGNIFIES A HIGHER NOMINAL RATE AND HENCE BENCHMARK RATE FOR THE ENTIRE CAPITAL MARKET. THE USE OF TREASURY BILL RATES FOR BOTH MONEY MARKET INSTRUMENTS AND INDEXED FLOATERS HAS THE SAME EFFECT. FINANCING OF FFB'S LOAN PORTFOLIO SIGNIFICANTLY INCREASES THE ANNUAL VOLUME OF TREASURY NEW ISSUES.

IN CONTRAST THE MARKETPLACE HAS NEVER VIEWED THE YIELD ON GUARANTEED DEBT OR AGENCY DEBT AS PRICING BENCHMARKS IN THE PRIMARY MARKET. WHILE THE VOLUME IN THE MARKET IS SUBSTANTIAL, IT HAS NEVER PLAYED THE YARDSTICK ROLE OF TREASURIES. IN THE ABSENCE OF A SIGNIFICANT SHIFT IN THE PROPORTIONS OF TREASURY DEBT AND AGENCY AND GUARANTEED DEBT BEING ISSUED IN THE PRIMARY MARKET, I DO NOT ENVISAGE THAT TREASURIES WILL EVER BE DISPLACED AS THE PRICING YARDSTICK.

(B) GUARANTEES WHICH HAVE BEEN CONVERTED BY FFB TO DIRECT LOANS HAVE AN ADVERSE REVENUE IMPACT ON STATE AND LOCAL TAXES AS GUARANTEES SOLD INTO THE PRIVATE SECTOR ARE SUBJECT BOTH TO STATE AND LOCAL

TAXES WHEREAS DIRECT TREASURIES, ISSUED BY TREASURY TO FINANCE FFB'S LENDING ACTIVITIES AND LOAN PORTFOLIO, ARE GENERALLY SUBJECT ONLY TO FEDERAL TAX. THE EFFECT OF FFB'S CONVERSIONS IS TO REDUCE THE STATE AND LOCAL TAX BASE.

(5) PROVIDING MARKET SUBSIDIZED RATES TO GUARANTEED BORROWERS, IT IS NOT AN UNMITIGATED BENEFIT TO ELIGIBLE BORROWERS.

FFB SERVES NO OVERSIGHT FUNCTION, ITS SOLE MANDATE BEING TO MAKE FUNDS AVAILABLE IN ANY AUTHORIZED MATURITY AT ANY POINT IN TIME UPON THE REQUEST OF ELIGIBLE BORROWERS. AS A RESULT, THERE IS NO MARKET OVERSIGHT, AND CONSEQUENTLY THERE IS THE POSSIBILITY OF THE ENCOURAGEMENT OF NON-COMMERCIAL TRANSACTIONS.

FFB GIVES NO MARKET OR INTEREST RATE ADVICE AT ALL. IN ADDITION, FOR ALL PRACTICAL PURPOSES, PREPAYMENT AND REFINANCING OF DEBT IS PROHIBITED BY FFB. LITERALLY SPEAKING, A BORROWER CAN PREPAY, BUT WITH A PREPAYMENT PREMIUM PAYABLE TO FFB ESSENTIALLY EQUAL TO HIS SAVINGS THROUGH REFINANCING AT A LOWER MARKET COUPON. IN VINTAGE ALICE-IN-WONDERLAND FASHION, A FFB BORROWER IS PERMITTED TO REFINANCE WITHOUT A PREPAYMENT PREMIUM ONLY WHEN IT WOULD COST THAT BORROWER MORE TO PREPAY AND REFINANCE FOR THE REMAINING TERM. AS A PRACTICAL CONSEQUENCE, A GUARANTEED BORROWER GIVES UP ALL FINANCING FLEXIBILITY BY FUNDING THROUGH FFB.

BANKERS, LAWYERS AND THE MARKETPLACE NECESSARILY EXERT DISCIPLINE OVER GUARANTEED BORROWERS IN PRIVATE SECTOR FINANCING. PROJECTIONS

ARE SCRUTINIZED, AND IF PROJECTIONS DO NOT WITHSTAND SCRUTINY, IMMEDIATE REMEDIAL ACTION IS FORCED UPON SUCH BORROWERS. FFB BORROWERS HAVE TOLD ME IN CONFIDENCE THAT BECAUSE OF THE AUTOMATICITY OF FFB FINANCING AND THE FACT THAT REGARDLESS OF MARKETPLACE CONDITIONS NON-MARKET MATURITIES AND TERMS ARE ALWAYS AVAILABLE THAT HARD DECISIONS HAVE BEEN POSTPONED, PROJECTS CONTINUED FAR BEYOND ANY JUSTIFICATION BASED ON THEIR ECONOMIC PROJECTIONS, AND MATERIAL LOSSES AND WASTE GENERATED THROUGH THE ABSENCE OF ANY MEANINGFUL OVERSIGHT. OBVIOUSLY, THIS IS UNDESIRABLE.

BY THE WAY, TWO ENDURING MINOR MYTHS REGARDING THE EFFICACY OF FFB RELATE TO THE ASSERTION THAT (A) GUARANTEED BORROWERS WHICH FINANCE IN THE PRIVATE SECTOR WOULD REQUIRE FINANCE STAFFS WHILE THOSE WHICH FINANCE THROUGH FFB DO NOT AND (B) THE FACT THAT BORROWERS WITH FFB ACCESS AVOID LEGAL AND FINANCIAL INTERMEDIARY FEES.

WHETHER A FINANCING IS FUNDED THROUGH FFB OR THROUGH THE PRIVATE SECTOR, GUARANTEED BORROWERS AND AGENCIES HAVE FINANCE STAFFS. A GREATER ORIENTATION TOWARDS PRIVATE SECTOR FINANCE THROUGH CURRENT GUARANTEED BORROWERS WITH ACCESS TO FFB WOULD NOT RESULT IN THE CREATION OF FINANCE STAFFS. THEY EXIST ALREADY. GIVEN THE FACT THAT GOVERNMENT GUARANTEED OR AGENCY DEBT IS "EXEMPT" DEBT, I.E., EXEMPT FROM ALL REGISTRATION REQUIREMENTS WITH THE SEC, PREPARATION OF THE UNDERLYING OFFERING DOCUMENTATIONS IS STRAIGHTFORWARD. SO ALSO IS

THE PREPARATION OF PRIVATE PLACEMENT OFFERING DOCUMENTATION AND DEBT PURCHASE CONTRACTS WHICH, IN ANY EVENT, ARE NEGOTIATED ALREADY WITH FFB.

THE MAGNITUDE OF PRIVATE SECTOR FINANCING FEES IS MODEST RELATIVE TO THE INTEREST RATE VOLATILITY COSTS OF THE MARKETPLACE. GETTING THE INTEREST RATE "RIGHT" IS A KEY CONSIDERATION. FFB IS NO HELP HERE. ANOTHER KEY CONSIDERATION IS HAVING THE RIGHT TO REFINANCE IN A LOWER RATE ENVIRONMENT. THAT RIGHT IS EFFECTIVELY PROHIBITED BY FFB.

WHAT DO FINANCIAL INTERMEDIARIES HAVE TO OFFER GUARANTEED BORROWERS WHICH OPT FOR PRIVATE SECTOR FINANCING? THEY CAN OFFER: (A) INTEREST RATE ADVICE AND (B) FINANCIAL AND PROJECT ADVICE.

BANKERS MONITOR INTEREST RATE DEVELOPMENTS. GIVEN THE VOLATILITY OF THE MARKETS, GETTING THE INTEREST RATE "RIGHT" IS OF CRUCIAL IMPORTANCE TO MOST PROJECTS. BANKERS ACHIEVE THIS IN TWO WAYS: (I) ADVISING BORROWERS ON MARKET TIMING BASED ON THEIR INTEREST RATE EXPERTISE; AND (II) STRUCTURING THE TERMS OF A TRANSACTION SO THAT IT IS MOST RESPONSIVE TO MARKET CONDITIONS AND DEMANDS AND, HENCE, OBTAINS LOWER RATES.

A BANKER TYPICALLY WILL ALSO REVIEW THE ECONOMICS OF A PROJECT DESPITE THE FACT THAT THE BORROWER IS GUARANTEED AND, HENCE, THERE IS NO CREDIT RISK TO POTENTIAL INVESTORS. LAWYERS AND BANKERS WILL ALSO SEE TO IT THAT MANAGEMENT OF THE GUARANTEED BORROWER IS QUERIED AS TO PROJECTIONS AND THE ECONOMIC ENVIRONMENT. THIS HEALTHY DISCIPLINE

IS A CHARACTERISTIC OF THE MARKETPLACE. ANOTHER CHARACTERISTIC OF THE MARKETPLACE IS TO PENALIZE GUARANTEE PROGRAMS WHICH HAVE HIGH DEFAULT RATES.

FFB MAKES NO INQUIRIES WHATSOEVER. AS LONG AS A BORROWER HAS A DULY AUTHORIZED GUARANTEE THAT GUARANTEE WILL BE AUTOMATICALLY FUNDED FOR THE AUTHORIZED TERM. INDEED, FFB HAS NEITHER THE STAFF NOR THE EXPERTISE TO MAKE CREDIT OR ANY OTHER INQUIRIES, AND, MOREOVER, IT HAS NO MANDATE TO DO SO.

AS PART OF ITS FINANCIAL ADVISORY ROLE, A BANKER WILL COUNSEL A GUARANTEED BORROWER ON SUITABLE TERMS AND CONDITIONS OF THE DEBT INSTRUMENT BEING FUNDED IN THE PRIVATE SECTOR, NOT MERELY AS TO WHAT THE MARKETPLACE AT THAT MOMENT IN TIME WISHES BUT ALSO WHAT IS DESIRABLE FROM THE PROJECT'S STANDPOINT IN TERMS OF DEBT AMORTIZATION, ACCELERATED DEBT REPAYMENT, AND PREPAYMENT OF THE DEBT IN WHOLE OR IN PART. AN INTELLIGENT USE OF MARKET STRUCTURE GIVES A GUARANTEED BORROWER CONSIDERABLE FLEXIBILITY WITH RESPECT TO THE REFINANCING OF HIGH COUPON DEBT IN A LOW COUPON ENVIRONMENT, FLEXIBILITY WHICH IS PRECLUDED AS TO FFB BORROWERS.

MR. CHAIRMAN, WE STRONGLY SUPPORT THE THRUST OF THIS BILL AND BELIEVE THAT IT WILL CONTRIBUTE MEASURABLY TO MORE ACCURATE BUDGET REPORTING.

THIS CONCLUDES THE FORMAL PART OF MY TESTIMONY.

APPENDIX I

CHAPTER V

SPECIAL ISSUES

A. FEDERAL FINANCING BANK

1. Background

The Federal Financing Bank (FFB) was established in 1973 to serve as a intermediary for the financing of obligations issued, sold, or guaranteed by government agencies. Its primary function is to coordinate and assist agency borrowing needs. The FFB has authority to obtain funds by selling its own securities in the priave market or it may borrow from the Treasury. As a matter of practice, the FFB obtains all its funds by borrowing from the Treasury. It is important to remember that FFB transactions are excluded by law from the budget totals and thus its lending activities are not treated as budget outlays and do not affect the budget deficit.

FFB purchases of government guaranteed borrowings of private entities is one of the most troublesome aspects of FFB activity. Normally under these arrangements, FFB makes loans directly to the private borrower whose obligations are guaranteed by a government agency. These guaranteed loans in actuality become direct federal loans outside the budget even though they are shown in agency accounts as "guaranteed loans."

The FFB, therefore, holds a key role in financing and managing lending by the Federal government and in assisting Federal agency borrowing generally. The importance of the FFB in these activities is illustrated by the fact that the FFB's lending activities accounted for $48.7 billion or 28 percent of the $175 billion in government receivables at September 30, 1979.

The growing impact of the FFB and certain of its lending practices have raised concerns about its activities. To address these concerns and assess the overall soundness of FFB activities from a credit management/debt collection perspective, the Debt Collection Project analyzed the FFB operations, the condition of its protfolio, and certain of its major loans.

Following is a summary of the Debt Collection Project findings and recommendations relative to the Federal Financing Bank. The detailed Project report on the Federal Financing Bank is published under separate cover.

2. Analysis of FFB Financings

The FFB financings analyzed by the Debt Collection Project included:

- o NASA Space Satellite Communications System
- o TVA Nuclear Fuel Lease Arrangement
- o Health Maintenance Organizations
- o Rural Electrification Administration
- o GSA Building Acquisitions
- o Defense Security Assistance Agency Guaranteed Loans

These financings were chosen because they are representative of the different types of FFB transactions. Additionally, a general assessment was made of the status of the FFB's portfolio. This included analyzing the percentage of the FFB's loans that were in a nonperforming status where the borrower was not meeting the original terms of the loan.

a. NASA Space Satellite Communications Syster

In 1976, NASA awarded to Western Union a $786 million contract in the form of a 10 year lease to own and operate a Tracking and Data Relay Satellite System (TDRSS) that will furnish telecommunications service to the agency. Western Union will also be able to use a portion of the system to furnish service to its commercial customers. The construction and launch costs for the entire system (estimated in 1976 at $586 million exclusive of interest) are being financed by the FFB.

NASA guaranteed "...through contract terms and conditions..." repayment of the FFB loan to Western Union "...subject only to the normal risk involving actual appropriations being made available on a timely basis...". NASA, moreover, pledged unconditionally to the FFB to make all debt service payments and all liability payments for the satellite system in the event of termination by NASA or default by Western Union.

Technically, this is a guaranteed loan. NASA is guaranteeing a loan for Western Union that is being funded by the FFB. In effect, NASA appears to be obligating funds in advance of appropriations. Moreover, from a budgetary standpoint, the contract is not fully funded at all. There has been no Congressional appropriation and no OMB apportionment. No appropriation of funds will be requested by NASA for TDRSS until the system is operational in 1983. It is the sense of the Debt Collection Project that this situation raises three fundamental legal issues.

- First, it is questionable whether the FFB could have accepted a NASA contract, even if fully funded, as an acceptable form of guarantee for the loan to Western Union.
- Secondly, it is not clear that NASA had specific authority to issue any sort of guarantee, much less one that takes the form of a fully funded contract.
- Lastly, since the contract was not fully funded, it appears that the FFB has made an unauthorized loan.

There is also another questionable legal issue here. In the June 19, 1975 Authorization Act for NASA that included TDRSS, Congress directed that the government shall incur no costs under such contract. In fact, the government has already incurred costs in the form of interest expense paid on FFB/ Treasury borrowings to finance the Western Union loan. The Debt Collection Project estimates that these costs are in the neighborhood of $60 million.

From the perspective of the original procurement decision, the initial analysis for the lease versus purchase decision seems to have been incomplete for three reasons. First, NASA did not consider in its analysis the alternative where the satellite system would be financed by a tax exempt institution such as a FFB. In using the FFB, all savings to NASA under the lease alternative are costs to the FFB and the Treasury. Therefore, with FFB financing, the purchase alternative should always be cheaper to the Government; yet, the NASA analysis concluded that a lease should be undertaken.

Secondly, the tax consequences may have not been fully analyzed. By retaining title to the system, Western Union may be able to generate a tax shield of about $300 million by claiming the investment tax credit and depreciation. Even if the lease is treated as an installment sales agreement by the Internal Revenue Service, Western Union's profits are taxed at the capital gains rate, rather than its marginal corporate tax rate. Finally, it is not clear why NASA should be extending an interest free loan to Western Union by funding the private portion of the investment costs. By using the FFB, this private portion also counts against the public debt limit.

As a result of the NASA arrangement with Western Union, Western Union has become a competitive leader with what it describes as the "...most powerful domestic communications satellite system in operation."

b. TVA Nuclear Fuel Lease

October 31, 1979, the Tennessee Valley Authority (TVA) entered a 30 year lease with the Seven States Energy Corporation whereby TVA will sell its nuclear fuel inventory to Seven States and later lease it back as needed. Concurrently, TVA arranged through the FFB a 5-year guaranteed loan with a $2.0 billion limit for Seven States to use in purchasing the nuclear fuel. The loan is priced according to 91-day Treasury bill rates. The initial drawdown on the loan was $490.6 million.

Because of nuclear plant construction slowdowns, utilities such as TVA have greater nuclear fuel inventory than needed and than financially prudent. The sale/lease-back arrangement allows TVA to treat the financing costs for its excess fuel inventories and the related debt as off-balance sheet items. As a result, this allows TVA to meet certain interest coverage and operating cost ratios that are mandated in its enabling legislation.

TVA had engaged Goldman Sachs, an investment banking firm, to develop a similar financing approach that would have been funded from the private commercial paper market with Bankers Trust backing up the commercial paper with a revolving bank credit. Goldman Sachs planned to raise up to $1.0 billion for TVA in this fashion with the initial tranche being $400 million. Then the Treasury Department apparently suggested to TVA that the FFB could provide the financing and a $2.0 billion facility was agreed upon.

A private utility's accumulation of nuclear fuel would be subject to credit review either by the commercial paper purchasers or by the commercial banks in the revolving credit. However, the FFB performed no independent credit review. Moreover, the financing has been structured in such a way that no financial risk has been passed to the fuel lessor, Seven States, or the lender, the FFB because TVA has guaranteed the loan.

TVA entered into the lease arrangement with Seven States pursuant to its authority to lease property as provided in the Tennessee Valley Authority Act. The sense of the Debt Collection Project is that TVA and the FFB are taking a very liberal interpretation of the TVA legislation. It is not clear that a lease is sufficient authority for the FFB to make the loan. It can be argued that the lease

is a form of collateral, but it is not a guarantee. It also can be argued that Seven States is not really a lessor, but just a bookkeeper. Moreover, nuclear fuel may not be considered "property" because it is a disposable item. The question is how can TVA "lease" disposable property which it will consume?

Lastly, the FFB provided TVA with a potential interest rate subsidy of up to $20.0 million annually by funding the lease at three month Treasury bill rates, rather than the more expensive commercial paper rates. Moreover, TVA is saving $6.8 million annually by not paying a commitment fee on the nuclear fuel facility's $1.3 billion undrawn balance at June 30, 1980. It is not clear, in fact, why the pricing of the loan should not be equivalent to private sources of funds. TVA customers are, in effect, receiving interest rate subsidies from the Federal government.

c. Health Maintenance Organization (HMO) Loan Activity

HMO's have been established to extend specific health services for a fixed, pre-paid fee. A revolving fund of $35.0 million provides funding for HMO loans up to $4.0 million apiece to cover operating losses in the first five years of operation. The HMO loans are sold to the FFB in order to replenish the revolving fund. The FFB had $96.0 million of HMO loans in its portfolio at June 30, 1980.

During the Debt Collection Project review of Office of Health Maintenance Organization (OHMO) activities, these conditions were observed:

- o OHMO had not defined formal loan policies and guidelines;
- o OHMO did not have a loan monitoring system; and,
- o Loan and grant administration procedures varied between headquarters and regions.

Private lenders would have required these types of financial controls. A private lender would also have required the provision of loan loss reserves. The assumption that all loans will be repaid is generous even when a financial institution is lending to established companies with substantial credit records. Since, loans were being made to new HMO's pioneering a new concept, OHMO should have been required to set up loss reserves and to develop effective loan monitoring practices. This sort of situation substantially increases the probability of loan defaults.

Defaults have occurred and the situation is becoming progressively worse. OHMO has repurchased $11.8 million in defaulted loans from the FFB. These included $2.4 million of defaults in FY 1979 and another $9.4 million as of April 1980. At least ten loans totaling $16.4 million are due and payable in July 1980. Between $3.5 million and $12.1 million of these loans were expected to be defaulted upon. While the revolving fund is limited to $35.0 million, the purchase of its loans by the FFB means there is no effective limit on the amount of OHMO guarantees. In effect, however, the FFB is assuming a credit risk for all loans losses over $35.0 million, yet a reserve for potential losses has not been established by the FFB.

d. Rural Electrification Administration Funding

At March 30, 1980, the Rural Electrification Administration (REA) had $16.7 billion in loans outstanding to finance rural electric and telephone utilities. REA funds itself by selling guaranteed obligations to the FFB and then acts as the Bank's agent in servicing the loans.

In 1972 and 1973, Congress passed legislation to reduce the impact of the REA loan program on the Federal budget. Based on this legislation, the REA/FFB funding arrangement would appear to violate congressional intent in these ways:

- The impact on the budget is not reduced. The FFB funds its REA obligations through the Treasury which in turn sells securities to the public. These security sales are counted towards the public debt limit, even though the monies are used to fund the REA's off-budget, guaranteed loans.
- Credit from private sources has not been substituted for Federal credit. The FFB is a wholly-owned government entity. The FFB is financing all of the REA guaranteed loans to the complete exclusion of private lending institutions.

The FFB could have worked with REA to develop alternative funding mechanisms for efficiently packaging REA's small and numerous loans. A Government National Mortgage Association (GNMA) mortgage backed security program allows individual mortgages to be pooled into a package that serves as collateral for a security that is large enough to be marketed to private institutional investors. The mortgage collateral is pledged to GNMA in return for a Federal guarantee of the security that is ultimately sold to the institutions. The same model might be used for the REA loans. REA

could continue to originate and service the rural utility and telephone loans and then use them as collateral for guaranteed securities that could be sold to private institutional investors. This would not involve appropriated funds or count against the public debt limits.

Another alternative for a model funding mechanism might be the one offered by the Farm Credit System. The banks of the Farm Credit System are chartered by the government and operate under Federal law. The Farm Credit System funds its loans by issuing securities in the private capital markets. At June 30, 1978, the Farm Credit System had issued $42.9 billion of securities. The capital markets view these securities as non-guaranteed, government agency debt, but they are not appropriated in the budget nor do they count against the public debt limit.

By helping REA evolve in the direction of GNMA or the Farm Credit System, the FFB would be acting as a financial adviser, rather than as an actual funding mechanism. This role would appear to be consistent with the intent of Congress to eliminate REA's impact on the budget by substituting private sources of funding for Federal credit.

e. GSA Building Acquisitions

In the mid-1970's, GSA sold $697.1 million of participation certificates to the public to finance and construct government buildings. Another $534 million of participation certificates were sold to the FFB.

In 1979, the trustee for the public issues issued "events of default" notices because about $7 million of certificates were not properly redeemed to meet mandatory sinking fund payments. The incorrect computation of the annual payments occurred because these computations were based on a percentage of the face amount of certificates rather than on the principal amount of purchase price, which included certificate proceeds and interest earned thereon.

GSA had to deposit funds with the trustee to resolve the asserted defaults. If payment of the $374 million of outstanding certificates in the two defaulted issues had been accelerated, necessary refinancing of the issues would have cost the government $7.5 million in higher interest rates the first year.

GSA also had been redeeming certificates at par to annual sinking fund requirements. The certificates, however, were selling below par in the secondary market where GSA could have bought them.

Even though GSA had no experience in the field of public debt management, it did not draw upon the Treasury's expertise. Instead, GSA paid $1.5 million in fees for professional services from a special counsel, a financial advisor, and a commercial bank trustee.

f. General Assessment of the FFB Portfolio

In order to make a general assessment of the FFB portfolio, a review was made of nonperforming loans. In generally accepted banking terms, a nonperforming loan is one where the borrower does not have the ability to meet the contractural terms of the loan. A nonperforming loan in the private sector can take one of two forms:

- o Nonaccrual basis where interest income and principal repayment are recognized only to the extent cash is received.
- o Renegotiated basis where the loan is being serviced regularly by the borrower, but at a rate of interest or on a repayment schedule different from those originally contracted for.

For the Federal government, there are two other forms of nonperforming loans that also should be considered. One is where the interest and principal payments are being made by the credit originating agency because the borrower does not have the ability to service the loan. The other is where a loan is being liquidated by a congressional appropriation because the borrower is unable to repay the loan.

The general assessment of the overall FFB portfolio at September 30, 1980, indicated that 5.3% of the loans are in a nonperforming status. This amounts to $4,355 million of nonperforming loans out of a $82.0 billion portfolio and they fall into the following categories:

- o $1,223 million of loans have had their payments and/or maturities rescheduled because the borrowers were not able to meet the original contractual terms of the loans.
- o $2,677 million of loans that will have to be liquidated by congressional appropriations because the borrowers are unable to repay the loans.

- o $455 million of loans where interest and principal payments are being made by the originating agency, rather than by the borrowers.

3. Findings and Conclusions of the Debt Collection Project

The Debt Collection Project concludes that the FFB has contributed to a deterioration of credit management by Federal agencies. Some critical management activities are not being performed well, and credit responsibilities of the originating agency, the FFB, and the OMB are blurred.

a. Role of FFB Board and Advisory Group

At present, the FFB Board of Directors is drawn entirely from within the Treasury Department.The Board members include:

(1) Secretary of the Treasury
(2) Deputy Secretary
(3) Under Secretary of Monetary Affairs
(4) General Counsel
(5) Fiscal Assistant Secretary

There have only been two or three formal board meetings since the FFB was founded in 1974. On the other hand, some of the board members meet informally as part of the weekly Financing Group meetings. At no time does there appear to have been formal board minutes kept of these meetings.

The FFB legislation provides that the Board of Directors shall determine the general policies for the operations of the bank and the duties of the officers. However, the legislation does not direct that the five person board come from within the Treasury. The Secretary of the Treasury must be the Chairman of the Board, but the other four shall be appointed by the President from any Federal agency or from the FFB staff.

The FFB also has an Advisory Council which was created by Presidential Executive Order in 1974. The Council was to provide advice and assistance to the board as well as serve as a coordinating forum to broaden support for the FFB. The membership of the Council consist of:

(1) Secretary of the Treasury (Chairman)
(2) Secretary of Agriculture
(3) Secretary of Commerce
(4) Secretary of Health and Human Services
(5) Secretary of Housing and Urban Development
(6) Secretary of Transportation
(7) President of the Export-Import Bank of the United States
(8) Postmaster General

The Council has been completely inactive and there has never been a formal meeting of the Council.

b. Staffing

The FFB presently has 3 full-time executives. It relies upon the Treasury's Bureau of Government Financial Operations to provide the accounting and recordkeeping support needed to maintain the FFB's portfolio.

As discussed later in the section on financial advice, the FFB does not have any personnel who are responsible for providing advisory services to the agencies. The FFB feels it can draw upon the staff of other offices in the Treasury if needed.

The Congressional legislation clearly allows for such staffing arrangements by permitting the FFB to charge borrowers for operating and servicing costs. The bank's FY 1979 income of $115 million is more than sufficient to pay for additional staff.

c. Credit Review Procedures

The FFB has no credit review procedures. The operating management of the FFB does not see credit review as one of the bank's responsibilities. Instead, the responsibility for credit review is left with the originating agencies. Also, the FFB does no ongoing monitoring of loans nor any overall financial evaluation of programs.When agencies approach the FFB, the FFB, within the limits of its charter and resources, only reviews the guarantee to ensure that the FFB bears no risk of loss.FFB performs no screening or analysis of the program being financed, the borrower's ability to repay, the real costs of benefits to the government of the funding arrangement, and, the alternate use of private market financing for the program. The FFB relies on the agencies to perform these analyses. This practice, in effect, removes checks and balances on the originating program agencies which frequently are under considerably greater pressure to extend Federal credit than to manage it.

As proven by the individual loans reviewed by the Debt Collection Project, this practice has the potential for (1) failure to design into the loan guarantee the essential elements of risk sharing, (2) use of Federal funds when private credit is available, and (3) lack of analysis of the full cost/saving to the Federal government as a result of these financing arrangements.

d. Credit Risk Sharing

The FFB operates as though it does not assume any credit risk because each loan is guaranteed by the originating agency. If a loan is defaulted upon, the FFB sells it back to the agency. Consequently, the FFB has made no provisions for loan loss reserves nor has it requested any agencies to set up loss reserves.

Regardless of the agency guarantees, the FFB is assuming credit risks. As a matter of fact, the FFB has indicated that it recognizes the risks involved and that it may have some bad loans, paticularly in credits extended to certain railroads. If a guarantee had to be enforced, the FFB would classify the loan on its financial statements as an account receivable until Congress could appropriate the money to reimburse the FFB. This procedure, however, still does not get at the issue of providing for poor credit risks.

e. Provision of Financial Advice

The FFB does not have, and does not want to have, the capability to provide financial advice to the agencies on structuring loans or developing financing plans, even though the FFB Act gives the FFB authority to approve:

- o the method of financing;
- o the source of financing;
- o the timing of financing; and,
- o the financing terms and conditions.

The bank does not view this as its function,even though it is clearly authorized in the bank's legislation.

The Treasury has the role of advising agencies on specific financings if asked or if authorized. The Treasury, on the other hand, cannot provide either the breadth or depth of advice that a leading investment banking firm can provide to its clients. Treasury's main strengths are limited to advising on marketing programs and on certain tax matters.

f. Pricing Policy

The FFB charges borrowers a uniform one-eighth of one percent fee over and above the Treasury's cost of borrowing. The FFB charge does not reflect the credit worthiness of the borrowers or the varying degrees of risk involved in different programs. The interest charge on a loan to a high risk borrower is based on the same formula as the interest charge on a loan to a low risk borrower. The benefits to the borrowers of this pricing policy can be substantial and often constitute additional subsidies or benefits to the borrowers.

Again, the FFB legislation provides for flexibility in the FFB's pricing policy. The only restriction on loan yields is that the interest rate shall not be less than Treasury or FFB issues of comparable maturity. Also, the FFB is authorized to charge fees for its commitments and other services.

g. Guaranteed Loans

One of the bank's fastest growing activities is the FFB purchases of agency guaranteed borrowings for private entities. Normally, under these arrangements FFB makes loans directly to the private borrower whose obligations are guaranteed by a government agency. These guaranteed loans, in actuality, become direct Federal loans outside the budget, even though they show up in agency accounts as "guaranteed loans." The government, through the FFB, becomes the direct lender in the "guaranteed programs" and assumes all the risks.

Based upon Debt Collection Project interviews, it is clear that the agencies recognize the FFB to be a convenient source of funds for their private sector borrowers. Funding provided by the FFB for the guaranteed programs is off-budget and does not affect agency outlays or the Federal budget deficit. A typical agency attitude is the one expressed by the Defense Security Assistance Agency: "In recent years (since 1975) preference has been given to guaranteed loans, which are financed 'off budget', and, therefore, direct loans receivable are on the decline".

As a result, guaranteed loan programs funded by the FFB are increasing rapidly. Guaranteed loans in the FFB portfolio totaled $14.4 billion in FY 1979 and are estimated to total $24.0 billion in FY 1980 and $30.9 billion in FY 1981.As a result of this growth, the financing of guaranteed loans has become a major part of the FFB's operations.

The Debt Collection Project views the FFB's purchases of guaranteed loans as one of the bank's most troublesome activities. In the most basic sense, the FFB is allowing the agencies to approve loans to themselves without an independent credit review.Other concerns about the FFB's guaranteed loans include:

- Neither the agencies nor the FFB view themselves as being accountable for the guaranteed loans. Generally, the agencies do not view themselves having responsibility for the guaranteed loans once they are sold to the FFB. On the other hand, the FFB does not view itself at risk for these guaranteed loans since the agencies are obligated to repurchase them in the event of default.

- The direct budget impact of the guaranteed loans is obscured because the FFB's guaranteed loans are not reflected in the budget deficit. Moreover, if a guaranteed loan goes bad, Congress must appropriate to the agency the funds necessary to reimburse the FFB. In effect, Congress is presented with a budgetary equivalent of an accomplished fact by the agency and the FFB. Congress has no direct control over the FFB's guaranteed loan activities, but must fund these loans in every respect if a default occurs.

- The FFB funding removes the opportunity for local involvement in the financing of guaranteed loans. In the case of HMO's, for example, funding for their guaranteed loans might be available from local economic development authorities, city and state governmental development authorities, or city and state governmental units. For the REA and TVA loans, private financial institutions almost certainly would have financed these guaranteed loans. Not only would this have generated tax revenues for the government from the private lenders' earnings, but it would have drawn financial resources from sectors of the capital market other than those that ordinarily invest in Treasury securities.

- There is a growing trend in the government that guaranteed loan sales to the FFB are not reported on the originating agency's financial statements. This accounting approach understates the actual level of liabilities that guaranteeing agencies have incurred and thus does not reveal a complete picture of the agency's total exposure to loan defaults and repurchase requirements. For example, the OHMO statement of financial condition as of September 31, 1979, listed outstanding direct loans as $25.77 million. However, outstanding loans of $83.64 million previously sold to the FFB were not reported on this statement. The omission of such a substantial contingent liability greatly understates the financial condition OHMO faces as guarantor of the loans. A continuation of the present default trend, necessitating futher OHMO loan repurchases from the FFB, would impact the continuation of the program. OHMO is likely to exceed its congressionally mandated appropriation limits unless additional funding is obtained from Congress.

- The Debt Collection Project believes that the FFB's primary responsibility was to coordinate and assist agency borrowing needs and not to become a direct lender for guaranteed programs. The original intent of the Administration and Congress in most of these guaranteed loan programs was to reduce or eliminate direct Federal loans and to substitute private funding for those programs. However, this has not occurred because of the FFB's lending activities.

4. Alternative for the Future

The FFB reduces the issuance and interest costs for agency debt, and by converting agency paper into Treasury issues, the FFB has eliminated problems of market coordination. Unfortunately, while achieving these important objectives, the FFB has created new problems and exacerbated existing difficulties with the control over Federal credit activities and the management of the Federal debt portfolio. Some critical management activities are not being performed well, and credit responsibilities of the originating agency, the FFB, and the OMB are blurred. Moreover, the entrance of the FFB into the guaranteed loan market created the situtation where "direct loans" through the FFB are not included in the budget totals as is the case with similar direct loans made through on-budget agencies. There are two alternatives to correct this situation:

- One alternative is to abolish the FFB while strengthening credit management in the agencies, Treasury, and the OMB. This will require clarifying responsibilities and instituting new procedures that will allow agencies to borrow directly from the Treasury when appropriate. One procedure would be a credit review of major loans and credit programs to ensure that there is a reasonable assurance of repayment and that loans are structured and funded in the best interests of the government. Since Treasury and OMB have agreed that credit review was OMB's responsibility, OMB would perform these credit reviews. Other procedures would include providing credit management advice to agencies as needed and ensuring that adequate provisions are made for loan loss reserves.

- The second alternative is to centralize all agency credit review and management activities in the FFB while minimizing the involvement of Treasury and the OMB. This will necessitate the development of the FFB into an independent functioning bank. The Board of Directors would be restructured and activated and would take an active role overseeing the policy of the bank. Specific recommendations are contained in the detailed FFB report prepared by the Debt Collection Project.

Either of these alternatives fills the valid role of coordinating agency borrowings and providing related financial advice to the agencies. Otherwise, and is presently the case, the FFB is little more than a bookkeeping operation that could be replaced by authorizing the agencies to borrow directly from the Treasury.

5. Recommendation of the Debt Collection Project

The Debt Collection Project recommends that the FFB be abolished. Building the FFB into an operating bank would simply duplicate functions and responsibilities that can be, and should be, performed in Treasury and the OMB. Moreover, the FFB does not want to assume an operating role or to expand its present staff.

Abolishing the FFB will require legislation. While awaiting enactment of such legislation, OMB and Treasury should agree upon administrative actions to control certain of the FFB's questionable activities. The administrative actions should be instituted immediately. One of these actions might be to have OMB review and approve all guaranteed loans that the FFB wants to fund. Another action might be to define strictly what is an acceptable guarantee. These controls can then guide the activities of the FFB until it is abolished and procedures are developed by OMB and Treasury to manage agency debt financings in the future.

Mr. PEASE [presiding]. Thank you very much, Mr. Warner.

We will turn next to Mr. Carl Coan, the legislative counsel for the National Housing Conference, and we will hear your testimony and then we can direct questions to all three panel members.

STATEMENT OF CARL A. S. COAN, JR., LEGISLATIVE COUNSEL, NATIONAL HOUSING CONFERENCE, INC.

Mr. COAN. Thank you, Mr. Chairman. I apologize for not being here when you started. I anticipated that the preceding panel would have taken longer.

My name is Carl Coan, and I am legislative counsel to the National Housing Conference, which is the Nation's oldest national organization concerned with the provision of decent housing for all Americans, especially the low and moderate income.

Since 1931, NHC has worked for and seen enacted a variety of Federal programs designed to improve the quality of housing in America and the availability of that housing on an affordable basis.

Among the key programs have been the Public Housing Program, enacted in 1937, and the Rural Housing Programs of the Farmers Home Administration, first enacted in 1949.

We believe that these two very important programs would be adversely affected if H.R. 4629 is enacted in its present form. We are not familiar with all Federal programs presently financed through the Bank, and therefore will not try to pass judgment on the efficacy of these proposals insofar as they apply to nonhousing programs.

We do know, however, the impact the bill will have on HUD's public housing and the farmers home rural housing programs. We feel the severity of that impact is such as to warrant full exemption of those programs from the provisions of the bill.

Under the public housing program since its inception in 1937, local housing authorities have financed their projects through the issuance of tax exempt obligations. These obligations are secured during the construction stage with a commitment by the Federal Government to make a direct loan for the full amount of the construction loan and afterward, by an annual contributions contract between the Federal Government and the local authority under which HUD pledges to make annual payments to the authority, up to an amount equal to the full principal and interest amounts required to pay off the housing authority's obligations. To assure the lowest possible interest rate, HUD many years ago began packaging the obligations of many different authorities for the purpose of consolidated sales at periodic times during the year.

This financing method worked very successfully up to 1974. In 1974, when interest rates rose above the level contemplated by HUD in reserving funds for the permanent financing of public housing projects, HUD temporarily discontinued the sale of long-term obligations, and instead rolled over the short-term construction notes. Even though interest rates subsequently fell below the level projected by HUD in its annual contributions contracts, it never returned to the long-term market.

Instead, for 10 years, it has continued to roll over short-term construction notes, all on behalf of the local housing authorities, with

the exception of a limited number of sales to the Federal Financing Bank starting in 1980.

Because the taxable interest rate that would have to be paid to the Federal Financing Bank is substantially higher than the tax exempt rate under which the projects were processed, large additional amounts of budget authority were required to be appropriated prior to the sales to the Bank. As a result, only a limited amount of sale authority has been approved, and in fact Congress last year, in the Housing and Urban-Rural Recovery Act of 1983, amended the U.S. Housing Act of 1937 for the purpose of stopping all future sales of public housing obligations to the Federal Financing Bank, and to require that all such future obligations be tax exempt.

This latter provision was in response to an OMB proposal to convert the program to taxable financing.

As we read H.R. 4629, it would seem to mandate that any future permanent financing of public housing projects be undertaken only through the Federal Financing Bank, as there were no obligations sold in the private markets during fiscal year 1983. This would require substantial additional contract and budget authority to cover the increased financing cost and would even, we believe, result in a double-counting of the budget authority necessary for a specific project. It would increase substantially the cost of each public housing unit produced at a time when low income housing has suffered greater budget cuts than any other major Federal program. Such a result would be inexcusable.

The situation is somewhat different with respect to the rural housing programs of the Farmers Home Administration. They are now financed through the FFB because this is the most efficient, cost-efficient method to do so. However, at the present time, Farmers Homes' budget actually reflects only the amount of out-of-pocket cost incurred by the Farmers Home Administration to support its housing activities above the amounts repaid by borrowers under its many programs.

If the full capital cost of loans made by Farmers Home Administration is required to be included in the budget, the Farmers Homes budget would increase, we understand, by about $2 billion annually. At a time when there is serious concern about the size of the budget deficit, we feel that such a budget increase resulting from statutorily mandated bookkeeping change can only result in a serious curtailment of Farmers Homes rural housing programs. These programs have already been cut back sharply, and the housing needs of rural America cannot afford further cuts.

We understand and sympathize with the concept of "truth in budgeting" meant to be forwarded by this bill. Nevertheless, we are seriously concerned that the major burden of forwarding that concept will fall upon those housing programs predominantly for the low and moderate income who are not sharing in the housing boom being experienced by upper and-middle-income Americans.

If the goal is really to achieve truth in budgeting, then we believe it should be carried out only in conjunction with two other major moves. The first is the adoption of a capital budget which recognizes the different nature of expenditures for the procurement of long-term assets or loans which will be repaid, such as is true for

the housing programs. The second is treating military procurements in the same way that the housing programs are now treated.

No individual, no business, and no other government besides the Federal Government lump together capital expenditures with expenditures for rubber bands, paper clips, and other such items. Because housing is a long-term asset which, if properly maintained, will last well beyond the period during which its capital cost is being paid off, it should not be treated in the same fashion as so-called wasting expenditures.

Insofar as the military budget is concerned, the authorization for the acquisition of a new ship or plane does not include in the budget the cost of operating and maintaining that ship or plane over its expected useful life, yet neither the ship nor the plane is of any use unless it is both operated and maintained, the cost of which will equal or exceed the direct procurement cost.

We urge the committee, if it chooses to proceed with H.R. 4629, to provide specific exemptions from its provisions for HUD's public housing program and the rural housing programs of Farmers Home Administration.

In closing, I want to mention one other housing area about which NHC has been concerned, and which we understand will now not be affected by the provisions of the bill. The Government National Mortgage Association's mortgage-backed securities program would have been covered by an earlier version of this legislation, with the result that this major secondary market for FHA and VA mortgages would have been killed. Fortunately, that disastrous effect has now been recognized, and we understand that the bill is designed and will be further amended, if necessary, to exempt completely GNMA activities from its coverage. For this we thank the bill's sponsor, and we urge that like treatment be provided for the public housing and rural housing programs.

Thank you.

[The prepared statement follows:]

STATEMENT OF CARL A. S. COAN, JR., LEGISLATIVE COUNSEL, NATIONAL HOUSING CONFERENCE

SUMMARY

-- H.R. 4629 would adversely affect Public Housing Program of HUD and Rural Housing Programs of the Farmers Home Administration.

-- The cost of public housing would be substantially increased.

-- The amount of budget authority necessary to support FmHA's Rural Housing Programs would have to be substantially increased.

-- The result would likely be further reductions in low and moderate income housing programs which have been most severely affected by budget reductions of recent years.

-- Realistic truth in budgeting requires the establishment of a capital budget and full accounting for military procurement activities.

-- The contemplated exclusion of the Mortgage Backed Securities Program of the Government National Mortgage Association from provisions of H.R. 4629 should be maintained and extended to Public Housing and Rural Housing programs.

STATEMENT

Mr. Chairman, Members of the Committee:

My name is Carl A. S. Coan, Jr. and I appreciate the opportunity to appear here today on behalf of the Natinal Housing Conference for which I am Legislative Counsel. The National Housing Conference is the Nation's oldest national organization concerned with the provision of decent housing for all Americans, especially the low and moderate income.

Since 1931, NHC has worked for, and seen enacted, a variety of Federal programs designed to improve the quality of housing in America and the availability of that housing on an affordable basis. Among the key programs enacted have been the Public Housing Program in 1937 and the Rural Housing Program of the Farmers Home Administration in 1949. We requested the opportunity to testify today because we believe that both of these important programs would be adversely affected if H.R. 4629 is enacted in its present form.

H.R. 4629 would amend the Federal Financing Bank Act of 1973 to place the activities of the Bank "on budget", and to limit the ability of Federal agencies to issue, sell, or guarantee obligations in the private securities market to that percentage of such obligations so financed in those markets during FY 1983. In other words, loans purchased by the Bank from a Federal agency would be considered as outlays, with a resultant increase in the budget authority of the issuing or guaranteeing agency, and those agencies, that now have broad discretion whether to finance their activities either directly in the private market or through the Federal Financing Bank, would have that discretion severely limited, and as a result, in many cases, find their budgets substantially increased.

While NHC does not pretend to be familiar with all Federal programs presently financed through the Bank and, therefore, will not try to pass judgment on the efficacy of these proposals insofar as they apply to nonhousing programs, we do know what impact the bill will have on HUD's Public Housing and FmHA's Rural Housing programs. We feel that the severity of that impact is such as to warrant full exemption of those programs from the provisions of the bill.

Under the Public Housing Program, since its inception in 1937, local housing authorities have financed their projects through the issuance of tax-exempt obligations. These obligations are secured during the construction stage with a commitment by the Federal Government to make a direct loan for the full amount of the construction loan and afterwards by an annual contributions contract between the Federal Government and the local authority under which HUD pledges to make annual payments to the authority, up to an amount equal to the full principal and interest amounts required to pay off the housing authority's obligations. To assure the lowest possible interest rate, HUD many years ago began packaging the obligations of many different authorities for the purpose of consolidated sales.

This financing method worked very successfully up to 1974. In 1974, when interest rates rose above the level contemplated by HUD in reserving funds for the permanent financing of public housing projects, HUD temporarily discontinued the sale of long-term obligations and, instead, rolled over the short-term construction notes. Even though interest rates subsequently fell below the level projected by HUD, it never returned to the long-term market. Instead for ten years, it has continued to roll over short-term construction notes, with the exception of a limited number of sales to the Federal Financing Bank starting in 1980.

Because the taxable interest rate that would have to be paid to the Federal Financing Bank is substantially higher than the tax-exempt rate under which the projects were processed, large additional amounts of budget authority were required to be appropriated prior to the sales to the Bank. As a result, only a limited amount of sale authority has been approved and, in fact, Congress last year in the Housing and Urban-Rural Recovery Act of 1983 amended the United States Housing Act of 1937 for the purpose of stopping all future sales of public housing obligations to the Federal Financing Bank and to require that all such future obligations be tax-exempt. This latter provision was in response to an OMB proposal to convert the program to taxable financing.

As we read H.R. 4629, it would seem to mandate that any future permanent financing of public housing projects be undertaken only through the Federal Financing Bank, as there were no such obligations sold in the private markets during FY 1983. This would require substantial additional contract and budget authority to cover the increased financing cost and would even, we believe, result in a "double-counting" of the budget authority necessary for a specific project. It would also increase substantially the cost of each public housing unit produced, at a time when low-income housing has suffered greater budget cuts than any other major Federal program. Such a result would be inexcusable.

The situation is somewhat different with respect to the Rural Housing programs of the Farmers Home Administration. Those programs are now financed through the Federal Financing Bank with insurance provided by FmHA, as this has been shown to be less expensive than the previous packaging of these loans and their direct sale in the private investment markets by FmHA. Therefore, we have no opposition to continuing the sale of those loans to the Bank, but we are seriously concerned about the implications of the proposal to put these activities fully on budget.

At the present time, as we understand it, FmHA's budget now only reflects the actual out-of-pocket costs incurred by FmHA to support its housing activities, above the amount repaid by the borrowers under its many programs. If the full capital cost of loans made by FmHA is required to be included in the budget, FmHA's budget would increase, we understand, by about $2 billion annually. At a time where there is serious concern

about the size of the budget deficit, we feel that such a budget increase, resulting from a statutorily mandated bookkeeping change, could only result in a serious curtailment of FmHA's housing programs. These programs have already been cut back sharply and the housing needs of rural America can not afford further cuts.

We understand and sympathize with the concept of "truth in budgeting" meant to be forwarded by this bill. Nevertheless, we are seriously concerned that the major burden of forwarding this concept will fall upon those housing programs predominently for the low and moderate income, who are not now sharing in the housing boom being experienced by upper and middle income Americans. If the goal is really to achieve "truth in budgeting", then we believe that it should be carried out only in conjunction with two other major moves. The first is the adoption of a capital budget which recognizes the different nature of expenditures for procurement of long-term assets or loans which will be repaid, such as is true for the housing programs. The second is treating military procurements in the same way that the housing programs are now treated.

No individual, no business, and no other government besides the Federal Government lump together capital expenditures with expenditures for rubberbands, paper clips, and other such items. Because housing is a long-term asset, which if properly maintained will last well beyond the period during which its capital cost is being paid off, it should not be treated in the same fashion as so-called wasting expenditures.

Insofar as the military budget is concerned, the authorization for the acquisition of a new ship or plane does not include in the budget the cost of operating and maintaining that ship or plane over its expected useful life. Yet, neither the ship nor the plane is of any use unless it is both operated and maintained--the cost of which will equal or exceed the direct procurement cost.

We urge the Committee, if it chooses to proceed with H.R. 4629, to provide specific exemptions from its provisions for HUD's Public Housing Program and the Rural Housing Programs of FmHA. The housing needs of the Nation's low income are too great to be buffeted further in the budget process.

In closing, I want to mention one other housing area about which NHC has been concerned and which we understand will now not be affected by the provisions of the bill. The Government National Mortgage Association's Mortgage Backed Securities Program would have been covered by an earlier version of this legislation, with the result that this major, secondary market for FHA and VA mortgages would have been killed. Fortunately, that disastrous effect has now been recognized, and we understand that the bill is designed, and will be further amended if necessary, to exempt completely GNMA activities from its coverage. For this, we thank the bill's sponsor and we urge that like treatment be provided for the Public Housing and Rural Housing programs.

Thank you for the opportunity to appear today. If there should be any questions, I will be glad to answer them.

Mr. PEASE. Thank you very much, Mr. Coan.

We will now turn to questions for all of the panel members from members of the committee.

Mr. Conable, do you have any questions?

Mr. CONABLE. I have no questions. I want to thank the panel for its expertise. I think we need some expertise in this area, and I expect these hearings to be quite instructive. Certainly the members now before us have contributed significantly.

Mr. PEASE. Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman.

I wonder if Mr. Abbott or Mr. Warner would care to respond to the allegations Mr. Coan made that the cost of public housing would be increased substantially?

Mr. Warner, would you care to comment?

Mr. WARNER. Excuse me. I did not understand the question.

Mr. DUNCAN. Mr. Coan made the point that the cost of public housing would be increased substantially. Would you care to respond to that statement by Mr. Coan?

Mr. ABBOTT. I am sorry. I do not have any particular expertise in that area.

Mr. GRADISON. Would the gentleman yield?

Mr. DUNCAN. I would be glad to yield.

Mr. GRADISON. I think it might be helpful to point out there may be a misunderstanding with regard to this. The low income public housing program has been financed privately all along. This bill would not change that.

Now, apparently it has been said that it would, and we ought to clarify that. But as a sponsor of the bill, I think it is important to make that point clear. I certainly understand the concerns expressed by Mr. Coan, but I want to assure him and others who share that concern that I don't think the bill does that, and would be happy to work with you to make sure that we all can read it the same way.

Mr. COAN. That is most welcome news, Mr. Gradison. I know of your interest in housing from your service on the Banking Committee and the Housing Subcommittee. And I would appreciate the opportunity to work with your staff. This is a concern, although we have heard that this other thought was there. But as we read the bill, and from what we see happening downtown, we are concerned that they would not interpret it that way.

So if I could meet with your staff, I would appreciate that opportunity.

Mr. GRADISON. I thank the gentleman for yielding.

Mr. DUNCAN. Also, may I ask you how do you think that Wall Street would respond today if these various issues were presented to the public?

Mr. WARNER. The issues presented by the bill or a return to financing away from FFB?

Mr. DUNCAN. Well, if you had really a significant or abrupt influx of let us say rural electric borrowing presented to the market today, what would happen?

Mr. WARNER. Well, first of all, pursuant to the amendments of 1981 to the Rural Electrification Administration Act, REA, guarantees must be presented to FFB, or they have the right to be pre-

sented to FFB for funding. So the REA loan guarantee program, which is the largest nonhousing guarantee program, already pursuant to the 1981 amendment, has a legal access to FFB from here on out subject to further amendment.

But REA borrowers, on balance, are very high quality borrowers, and the default rate under the REA guarantee program has been impeccable.

Mr. DUNCAN. Let us say rural electric bonds were being presented. Do you think that the securities market would favor larger corporate borrowers who were seeking the same funds? That is a concern that has been raised, that the securities market would do that.

Mr. WARNER. I think in the case of the REA area there are only a handful of REA G&T co-ops, who have been really massive borrowers recently, and that is typically in connection with nuclear or other major power facilities.

Size is important. Size and repeat issuance is important in terms of the best possible reception on Wall Street. It could be that the REA area would be viewed as a generic area in some ways, so consequently, the perception would be not one guaranteed REA coming in with $50 million to finance and another with $250 to finance, but maybe just a generic product given, as I say, the exceptional security which co-ops have demonstrated over the past 40-odd years. So I think a lot would depend upon market perception.

The REA area is not very visible. The REA supervised cooperative area is not very visible to Wall Street, in general, and it would really be a question of future perceptions.

Mr. DUNCAN. In other words, you do not know then? Is that the sum and substance of what you are saying? You do not know what would happen?

Mr. WARNER. I know that the reception would be either good or very good.

Mr. DUNCAN. Would the interest rates be higher than are being paid today by using the Federal Financing Bank?

Mr. WARNER. Absolutely.

Mr. DUNCAN. They would be higher.

Mr. WARNER. Yes.

Mr. DUNCAN. Thank you, Mr. Chairman.

I would like to ask unanimous consent that I may submit questions to this panel, as well as others, if I so desire, in writing, and that they may respond.

Mr. PEASE. Without objection, so ordered.

The gentleman from Ohio, Mr. Gradison.

Mr. GRADISON. I want to thank the chairman and indicate that the purpose of the bill is not with regard to the REA's and, of course, is not to change their access to the credit markets. Indeed, the requirement of going through the Federal Financing Bank would continue, and therefore, their access to the preferred interest rates which are obtained by using the Federal Financing Bank would also continue.

So I think that, at least in my mind, should allay any concerns which they might have about possible increased interest cost which might occur. Certainly there is no intention on my part as sponsor of the bill to even permit the use of financing out of the Federal

Financing Bank by the REA. This really has nothing to do with this. This is a matter of making sure that such financing as does take place through the FFB is included in the budget. That is the long and the short of it.

Mr. PEASE. Mr. Coan, I am interested in the distinction you draw between public housing projects and rural housing programs of the Farmers Home Administration. You say the latter programs are now financed through the FFB with insurance provided by Farmers Home, as this has been shown to be less expensive than the previous packaging of these loans and their direct sale in the private investment market by FMHA.

Is FMHA financing taxable?

Mr. COAN. Yes, it is, Mr. Chairman.

Mr. PEASE. So that while the FFB financing of that may be less expensive than a previous practice, it still would be more expensive than the issuance of tax-exempt bonds, as is the case for public housing?

Mr. COAN. Yes.

Mr. PEASE. All right. Thank you.

Any other questions?

[No response.]

Mr. PEASE. If not, thank you very much, all three of you, Mr. Coan, Mr. Abbott, and Mr. Warner. And we will call up our next panel which includes two persons: Mr. Joseph Vellone, special counsel, National Telephone Cooperative Association; and Charles A. Robinson, Jr., deputy general manager of the National Rural Electric Cooperative Association.

Mr. Robinson, would you like to begin, please?

STATEMENT OF CHARLES A. ROBINSON, JR., DEPUTY GENERAL MANAGER, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION, ACCOMPANIED BY DON SMITH, CHIEF ECONOMIST

Mr. ROBINSON. Mr. Chairman, thank you very much.

My name is Charles Robinson. I am deputy general manager of the National Rural Electric Cooperative Association. I am accompanied this morning at the witness table by Mr. Don Smith, our chief economist. In the event that my voice totally gives out before I am finished, I might ask Don Smith to complete my statement.

We very much appreciate this opportunity to express our views on H.R. 4629. Let me begin by saying that I believe the vast majority of our members are in accord with the basic objectives of H.R. 4629; that is, to make certain that all Federal expenditures are subject to control by Congress, and that accounting for them is open to public scrutiny and reasonably understandable.

At the same time, however, rural people are deeply concerned about the future of the REA financing program, a Federal loan program which has brought about substantial and well-documented social and economic improvements benefiting not only rural areas but the Nation as a whole, and on which the repayment record approaches 100 percent.

When the Rural Electrification Act was amended in 1973 through Public Law 93-32, the Congress clearly expressed its belief that the control which Congress itself retained to annually estab-

lish the loan levels for REA was adequate in terms of a mechanism for oversight of the rural electric program, and that further controls for the inclusion of these transactions in the unified budget would be unnecessary and redundant.

This concept is emphasized in the Rural Electrification Act itself wherein no fewer than six different places Congress states its intent expressly that REA loan levels and advances be excluded from the annual Federal budget totals, and that these loans not be charged against any statutory limitations on Federal expenditures and lending by Government.

In this light we believe that the present budgetary treatment of the Federal Financing Bank's transactions with REA is fully consistent with these provisions of the Rural Electrification Act and provides Congress and the public with full and complete information on the nature and volume of such transactions.

Each year, Mr. Chairman and members of the committee, the insured and guaranteed loan levels recommended by OMB for REA are printed in the budget documents, are reviewed by the Budget Committees of both Houses of Congress in formulating the budget resolution, are reviewed by the Appropriations Committees of both Houses in marking up the U.S. Department of Agriculture appropriations bill, and are specified and limited in the Agriculture Department's Appropriations Act.

Moreover, transactions between REA and the bank do not result in any transfer of on-budget loan authority to off-budget status, or any increase in loan authority beyond that approved by Congress and shown in the budget documents. And as we understand it, funds raised by Treasury for the FFB are included in the totals of the public debt.

We, therefore, do not understand the advantage of the language at line 4 of page 2 of H.R. 4629 which would apparently place on budget the REA insured and guaranteed loan programs to the extent that they are financed by the Federal Financing Bank.

This matter is addressed slightly differently in the Senate counterpart of H.R. 4629. Although the Senate bill also attributes FFB's outlays and budget authority to the pertinent agency—in this case, REA, and we have no objection to that whatever—it appears to not change the budget status of the agency.

The final sentence of section 2 of S. 2213 contains the following language instead of that found at the same place in H.R. 4629: "(2) Nothing in this subsection affects the budget status of federal agencies issuing, selling, or guaranteeing obligations purchased by the bank under Section 6(a) of this Act."

This language of S. 2213, we are advised by its sponsor, is intended to avoid changing the budget status of agencies using the bank or the programs of such agencies. The language of the Senate bill, if we interpret it correctly, would seem to take care of our concern in this regard. In other words, the money which is utilized in the REA insured and guaranteed loan programs and approved by Congress already shows up in the budget and already shows up as attributed to that agency. We have no problem with that whatever. The problem we have, I think, is that this language in the House bill would place the REA program on budget.

We are also seriously concerned that a revision of budgetary procedures applicable to the Federal Financing Bank could directly or indirectly result in the imposition of new restraints on our access to the bank, forcing REA and/or its borrowers to seek additional financing directly from the market. Even with the exemplary record of repayment that has been established by the REA program, there is good reason to wonder, we feel, how Wall Street would respond to a significant and abrupt influx of rural electric borrowings, even with the REA guarantee in place.

Because of this, it is conceivable that some rural electrics would be unable to raise the capital they need at any price or at such a high interest rate as to render the effort self-defeating. Either alternative would clearly damage the quality of service we can provide to the rural people of America.

In this connection, our concerns relate to section 3 of H.R. 4629, which would amend section 7 of the Federal Financing Bank Act to insert language mandating the purchase by the FFB of Federal agency securities unless "The originating agency can demonstrate to the Secretary of the Treasury that, on balance, program purposes can best be served by financing through investment securities markets."

Under existing law, the holder of an REA loan guarantee has the discretion to use whatever means of financing is believed to be in the best interest of the consumer member, including but not limited to the Federal Financing Bank.

As we read it, section 7 of H.R. 4629 could be interpreted to transfer this discretion from the holder of the guarantee to the Secretary of the Treasury and the REA Administrator, either requiring a holder to use the FFB or forcing him to the open securities market as the Secretary and Administrator might decide. The result could well be substantially higher cost of electricity for rural families and businesses across the country.

Mr. Chairman, section 4, however, of H.R. 4629 appears intended to recognize this problem and to protect the holders of REA loan guarantees in their presently existing right to use either the FFB or the non-Federal securities markets for the funding of such guaranteed loans, as well as protect the purchase by the FFB of certificates of beneficial interest in the REA electric and telephone revolving fund when offered by the Administrator.

Mr. Chairman, we certainly welcome this language, which for us represents a significant change from some of the earlier drafts. If our interpretation of section 4 is erroneous, we would certainly appreciate clarification. As we read section 4, it is our understanding that this would protect against any change whatever in the option of the holders of REA loan guarantees to either use the Federal Financing Bank or not use it. It is our understanding that section 4 would preserve present law.

In summary, Mr. Chairman, we believe that in view of the annual detailed review by Congress of REA loan programs and the fact that the size of these programs is annually specified by Congress, there is no purpose to be served by changing the budget status of REA or its programs.

Moreover, we disagree with the concept that guaranteed loans be treated in the budget simply as an outlay, when in fact they simul-

taneously represent a significant asset to the Government. In our judgment, a more appropriate, and we believe equitable, approach would be the implementation of a separate capital budget which would provide a means to recognize and account for the value of all assets held by the Government, including, of course, the secured notes payable by REA borrowers. If that kind of budget were in place, the REA loan program would simply be an exchange of assets; an exchange of cash for an account receivable. NRECA has for many years supported the creation of a capital budget for the Federal Government and continues to do so today.

In addition, we are also deeply concerned that the language contained in section 3 not change existing law under which the holders of REA loan guarantees are assured access to the Federal Financing Back and to all other sources of investment capital for the funding of these guarantees.

Finally, Mr. Chairman, in terms of the present system providing budgetary overview and control of the REA program, I would point out that between fiscal year 1980 and fiscal year 1984 the annual total of REA's insured and guaranteed loan programs has decreased from $6.6 billion to less than $4.1 billion, and it is estimated to drop to about $2 billion for fiscal year 1985, a decrease of 70 percent in 5 years.

During this same period, the same period when the REA loan program total dropped by 70 percent, the total Federal budget has increased from $575 billion to some $925 billion, an increase of 60 percent. So that while REA loans and loan guarantees combined have gone down by 70 percent, the total Federal budget has increased by 60 percent.

We, therefore, respectfully urge on the committee a recognition of the fact that as to REA loan programs, the combination of a responsible constituency and the annual specification each year of loan levels by Congress has constituted a very effective budget control mechanism.

Mr. Chairman, again, our appreciation and thanks to the committee, to the chairman and to the members for hearing us in this matter.

[The prepared statement follows:]

STATEMENT OF CHARLES A. ROBINSON, JR., DEPUTY GENERAL MANAGER, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE

My name is Charles A. Robinson, Jr. I am Deputy General Manager of the National Rural Electric Cooperative Association, the national service organization of non-profit cooperatives which provide electric service to the agricultural areas of 46 states.

We appreciate very much this opportunity to express our views on H.R. 4629. Let me begin by saying that I believe the vast majority of our members are in accord with the basic objectives of H.R. 4629; that is to make certain that all Federal expenditures are subject to control by Congress and that accounting for them is open to public scrutiny and reasonably understandable.

At the same time, however, rural people are deeply concerned about the future of the REA financing program -- a Federal loan program which has brought about substantial and well-documented social and economic improvements, benefiting not only rural areas, but the nation as a whole, and on which the repayment record approaches 100%.

When the RE Act was amended in 1973, through Public Law 93-32, the Congress clearly expressed its belief that the control which Congress itself retained to annually establish the loan levels for REA was an adequate mechanism for oversight of the rural electric program, and that further controls through the inclusion of these transactions in the unified budget would be unnecessary and redundant.

This concept is emphasized in the RE Act itself, where in no fewer than six different places, Congress states its intent that REA loan levels and advances be excluded from the annual Federal budget totals, and that these

loans not be charged against any statutory limitations on Federal expenditure and net lending (Budget outlays) by government.

In this light, we believe that the present budgetary treatment of the Federal Financing Bank's transactions with REA is fully consistent with these provisions of the RE Act, and provides Congress and the public with full and complete information on the nature and volume of such transactions.

Each year, the insured and guaranteed loan levels recommended by OMB for REA are printed in the Budget documents, are reviewed by the Budget Committees of both Houses in formulating the Budget Resolution, are reviewed by the Appropriations Committees of both Houses in marking up the USDA Appropriations Bill, and are specified and limited in the Agriculture Department's Appropriation Act. Moreover, transactions between REA and the Bank do not result in any transfer of on-Budget loan authority to off-Budget status, or any increase in loan authority beyond that approved by Congress and shown in the Budget documents. And, as we understand it, funds raised by Treasury for the FFB are included in the totals of the public debt. We, therefore, do not understand the advantage of the language at line 4 of page 2 of H.R. 4629 which would apparently place on Budget the REA insured and guaranteed loan programs to the extent that they are financed by the FFB.

This matter is addressed differently in the Senate counterpart of H.R. 4629. Although the Senate bill also attributes FFB's outlays and Budget authority to the pertinent agency, it appears to not change the Budget status of the agency. The final sentence of Section 2 of S. 2213 contains the following language instead of that found at the same place in H.R. 4629:

> "(2) Nothing in this subsection affects the budget status of Federal agencies issuing, selling, or guaranteeing obligations purchased by the

Bank under Section 6(a) of this Act."

This language of S. 2213, we are advised by its sponsor, is intended to avoid changing the Budget status of agencies using the Bank or the programs of such agencies. The language of the Senate bill, if we interpret it correctly, would seem to take care of our concern in this regard.

We are also seriously concerned that a revision of budgetary procedures applicable to the Federal Financing Bank could directly or indirectly result in the imposition of new restraints on our access to the Bank, forcing REA and/or its borrowers to seek additional financing directly from the private market. Even with the exemplary record of repayment that has been established by the REA program, there is good reason to wonder, we feel, how Wall Street would respond to a significant and abrupt influx of rural electric borrowings, even with the REA guarantee in place. Because of this, it is conceivable that some rural electrics would be unable to raise the capital they need at any price, or at such a high interest rate as to render the effort self-defeating. Either alternative would clearly damage the quality of service we can provide to the rural people of America.

In this connection, our concerns relate to Section 3 of H.R. 4629 which would amend Section 7 of the FFB Act to insert language mandating the purchase by the FFB of Federal agency securities unless "The originating agency can demonstrate to the Secretary of the Treasury that, on balance, program purposes can best be served by financing through investment securities markets."

Under existing law, the holder of an REA loan guarantee has the discretion to use whatever means of financing is believed to be in the best interest of the consumer member, including the FFB. As we read it, Section 7 of H.R. 4629 could be interpreted to transfer this discretion from the holder of the guarantee to the Secretary of the Treasury and the REA adminis-

trator; either requiring the holder to use the FFB or forcing him to the open securities market as the Secretary and Administrator might decide. The result could well be substantially higher costs of electricity for rural families and businesses across the country.

Section 4 of H.R. 4629 appears intended to recognize and protect the holders of REA loan guarantees in their presently existing right to use either the FFB or the non-Federal securities markets for the funding of such guaranteed loans, as well as protect the purchase by the FFB of certificates of beneficial interest in the REA Electric and Telephone Revolving Fund when offered by the Administrator. We certainly welcome this language, which for us represents a significant change from some of the earlier drafts. If our interpretation is erroneous, we would appreciate clarification on this point.

In summary, we believe that in view of the annual detailed review by Congress of REA loan programs, and the fact that the size of these programs, is annually specified by Congress, there is no purpose to be served by changing the Budget status of REA or its programs. Moreover, we disagree with the concept that guaranteed loans be treated in the Budget simply as an outlay when, in fact, they simultaneously represent a significant asset to the government. In our judgment, a more appropriate, and we believe, equitable approach would be the implementation of a separate "capital budget," which would provide a means to recognize and account for the value of all assets held by our government, including, of course, the secured notes payable by REA borrowers. NRECA has for many years supported the creation of a capital budget for the Federal government and continues to do so today.

In addition, we are also deeply concerned that language contained in Section 3 of H.R. 4629 not change existing law under which holders of REA loan guarantees are assured access to the FFB and to all other sources of

investment capital for the funding of these guarantees.

Finally, in terms of controlling overall Federal expenditures we respectfully point out that between F.Y. 1980 and F.Y. 1984, the annual total of REA's insured and guaranteed loan programs has decreased from $6.6 billion to less than $4.1 billion, and is estimated to drop to about $2 billion in F.Y. 1985, a decrease of 70% in five years. During this same period, the total Federal Budget has increased from $575 billion to some $925 billion, an increase of 60%. We, therefore, respectfully urge on the Committee, a recognition of the fact that, as to REA loan programs, the combination of a responsible constituency, and the annual specification of loan levels by Congress, has constituted a very effective Budget control mechanism.

Mr. PEASE. Thank you, Mr. Robinson. We appreciate your testimony.

STATEMENT OF JOSEPH VELLONE, SPECIAL COUNSEL, NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

Mr. VELLONE. Mr. Chairman and members of the committee, my name is Joseph Vellone. I am appearing here as special counsel for the National Telephone Cooperative Association, the NTCA.

NTCA is a national service organization representing some 450 telephone cooperatives and other locally owned and operated small telephone systems. The systems provide telephone service for 5 million subscribers in the most rural areas of 42 States, Guam, and Puerto Rico.

We appreciate this opportunity to present our views in H.R. 4629, named by its sponsor as the Truth In Budgeting Act of 1984. Its principal objectives appear to be: (a) to include the receipts and disbursements of the Federal Financing Bank [FFB], in the unified budget as receipts and disbursements of the agencies whose programs are financed through the FFB; and (b) to require Federal agencies to finance through the FFB all obligations, with few exceptions, which they issue, sell or guarantee, if such obligations are of the type ordinarily financed in investment and security markets.

NTCA member systems rely on loans and loan guarantees under programs administered by the Rural Electrification Administration [REA], which are generally financed through the FFB. NTCA is concerned that if enacted as introduced, H.R. 4629 could create problems in the administration of the REA programs and hinder small telephone systems in obtaining favorable financing from nongovernmental sources under REA guarantees.

NTCA therefore recommends that the committee give full consideration to the following issues in its review of this legislative proposal.

One, the REA programs receive extensive review under the present congressional budget process.

They are included in the Federal credit budget which has supplemented the unified budget since 1980. The Federal credit budget is the aggregate of the direct loan obligations and guaranteed loan commitments in the fiscal year. By presenting the total volume of Federal credit, the credit budget facilitates administrative and legislative control over individual credit programs through limitations set in appropriation acts.

Each fiscal year the levels of the REA and Rural Telephone Bank, the RTB programs, and the REA loan guarantee program are recommended by the President, reviewed by the House and Senate Agriculture and Appropriations Committees and included in an appropriation bill which requires approval by both Houses before being submitted to the President for his signature.

Two, loan levels rather than budget authority or outlays are the meaningful controls for loan and loan guarantee programs.

Once a loan or a loan guarantee has been legally made within the constraints established by Congress, it is too late to attempt to control the resulting budget authority—the authority to borrow to supplement collections and other available funds to make advances required by loan contracts or outlays—the two basic elements of the unified budget.

Three, costly delays can result from attempts to control advances of funds required under binding loan contracts approved in prior years.

Advances under such contracts are made over periods as long as 7 years or more. If loans from REA's revolving fund, from the RTB and from lenders under an REA guarantee are subjected to outlay restrictions, REA and other lenders may not be able to honor their loan contracts which require the lender to make advances to the borrower as construction progresses.

The potential disruption in construction can add materially to the cost of completing large projects as interest and other obligations continue to accrue when construction is suspended. In enacting the 1973 amendments to the Rural Electrification Act, Congress recognized this by authorizing the establishment of levels for loans and loan guarantees while excluding the amounts of advances under REA and RTB loans and REA loan guarantees from the total of the budget and any limitation imposed by statute on expenditures and net lending (budget outlays) of the United States.

Four, section 3 of H.R. 4629 may prevent established lending agencies, such as the banks for cooperatives—the BOC's—and the National Rural Utilities Cooperative Finance Corporation [CFC] from participating in the REA guarantee programs, even when their interest rates would be lower than FFB's.

A borrower with an REA guarantee commitment now has the right to select the lender whose terms it believes would be the most beneficial for the people served by the borrower. Section 3 of H.R. 4629, however, would add a new subsection to the FFB Act, which would permit a Federal agency to guarantee obligations financed in the investment securities market only to the extent of the percentage of its activities obligated or disbursed in such markets in fiscal year 1983.

There were no amounts obligated and only negligible amounts disbursed, however, under REA guarantees in fiscal year 1983 in such markets—assuming a loan made by a Bank for Cooperatives is considered to be one obligated or disbursed in the "investment securities markets," a term not defined in H.R. 4629.

Advances in fiscal year 1983 on loans guaranteed by REA totaling some $3,214 million were made by the following lenders:

	Amount	Percent
Federal Financing Bank	$3,154,000,000	98
St. Paul Bank for Cooperatives	60,000,000	2

The percentage test in the proposed FFB Act subsection 7(a)(1)(A) could thus effectively bar BOC's and CFC from participating in the REA guarantee program.

Under the 1973 REA Act Amendments, the interest rate on guaranteed loans is the rate agreed upon by the borrower and the lender. H.R. 4629, however, would add another subsection, 7(a)(3), to the FFB Act, requiring the Secretary of the Treasury to approve a request for financing in the security markets instead of financing by FFB if the Federal guarantor makes the request and shows "lower costs from private financing."

Under such a procedure, the borrower's decision to use private financing could easily be nullified by disputes over comparative interest rates, particularly if variable interest rates are involved, by a guarantor's delay or refusal to submit the borrower's proposal to use private financing to the Treasury, or by an adverse decision on the proposal by Treasury officials interested in promoting greater use of the Federal Financing Bank for obligations it is interested in financing.

The multiple levels of review by two Federal departments of a non-Federal entity's decision to use private financing, particularly financing which does not involve the sale of the borrower's own obligations to the general public, is difficult to justify at a time when unnecessary regulation of small business has become a popular nonpartisan objective.

It should be noted that Assistant Secretary of the Treasury, Roger W. Mehle, testified on April 4 of last year at the Senate Committee on Banking, Housing and Urban Affairs hearing that:

> Currently, FFB's standard loan terms call for the FFB rate to be set at one-eighth of one percentage point above the prevailing Treasury market rate for obligations with similar terms and maturity dates. After deduction for relatively insignificant FFB administrative expenses, FFB's earnings are returned to the general fund of the Treasury. In fact, FFB has returned $784 million of surpluses to the Treasury since it began operations in 1974.

Any change in the present law should not prevent a loan from a lender that can meet or beat the FFB rate. The FFB rate is higher than necessary to cover its costs and might be further increased if there are no prospective competitors.

Five, many terms in H.R. 4629 require clarification, either by expansion of the definition section in the Federal Financing Bank Act of 1973 or otherwise to avoid potential conflicts in their interpretation.

Examples of terms requiring clarification include:

(a) Investment securities markets, private financing, private markets, private institutions and financial markets. Do the terms have identical meanings, or are there distinctions which should be noted? Are loans made by the Banks for Cooperatives, insurance companies and other lending institutions which do not involve the sale of the borrower's own obligations to the general public considered to be financing covered by the "investment securities markets" term?

(b) Organizations: This term is used in section 4 of H.R. 4629. We assume this term includes corporations and other organizations borrowing under a guarantee by a Federal agency, as the rights of Federal agencies are already covered by section 17 of the present act.

Six, enactment of H.R. 4629 would result in a number of other problems. Among these is the fact that the bill does not assure that the same budget authority and outlay will not be counted more than once in the unified budget. A provision to this effect should have been included in section 2 of the bill.

Section 5(b) of the bill raises serious questions by attempting to give preferred status to this bill, if enacted over any future acts inconsistent therewith, which do not expressly amend the Federal Financing Bank Act of 1973. This provision is unnecessary if established provisions for joint or sequential referral to all committees which have jurisdiction over this subject matter are followed.

And, seven—and I am happy to note that there are other witnesses today who advocated this alternative—seven, there is a better alternative to the proposed legislation: a separate capital budget.

Prof. Norman Orenstein in an article published in the Washington Post on September 26, 1982, when he was a visiting scholar at the American Enterprise Institute, pointed out that as many as 45 States have separate capital budgets. These States divide their budgets into two categories: current outlays or day-to-day operating expenses, and capital programs. Capital programs cover investments instead of operating expenses.

Combining investments and expenses in a unified budget obscures truth in budgeting by overstating operating deficits. If a business enterprise attempted to deduct its purchase of assets such as an office building or bonds of another corporation from its income tax return, it could expect to receive a not-too-friendly visit from an Internal Revenue Service agent.

The proposed legislation would increase the reported deficit, while establishing a separate capital budget would substantially reduce the operating deficit and make it easier to balance the current outlay budget in future years.

In conclusion, NTCA recommends that H.R. 4629 not be enacted as introduced for the reasons set forth in this statement; that is,

(1) The REA programs receive extensive review under the present congressional budget process;

(2) Loan levels rather than budget authority or outlays are the meaningful controls for loan and loan guarantee programs;

(3) Costly delays can result from attempts to control advances of funds as required under binding loan contracts approved in prior years;

(4) Section 3 of H.R. 4629 may prevent established lending agencies from participating in the REA guarantee program even when their interest rates would be lower than FFB's;

(5) Many terms in H.R. 4629 require clarification to avoid potential conflicts in their interpretation;

(6) Enactment of H.R. 4629 would result in a number of other problems; and

(7) There is a better alternative to the proposed legislation: a separate capital budget.

We appreciate this opportunity to present our views and would be pleased to respond to your questions.

Thank you.

Mr. PEASE. Thank you very much, Mr. Vellone. We appreciate your testimony as well.

Are there questions?

Mr. Duncan.

Mr. DUNCAN. I have no questions, Mr. Chairman.

Mr. GIBBONS. Mr. Gradison.

Mr. GRADISON. Thank you, Mr. Chairman.

I want to thank both of the witnesses for their testimony. There certainly are some points they raised which should be dealt with and revisions that are made in H.R. 4629.

The point specifically raised by Mr. Vellone in his point No. 4 is one which came to our attention for the first time yesterday. There may be a way to deal with it by referring to something—and I am not sure about these exact words—but something like the percentage or level of borrowing from outside sources. We would like to work with you on that point.

Mr. VELLONE. We would be pleased to.

Mr. GRADISON. With regard to the point raised by Mr. Robinson with respect to the access by REA to financing sources other than the Federal Financing Bank, as he noted at the top of page 4 in his own testimony, there is a new section 4 in H.R. 4629, which was drafted by the National Rural Electric Cooperative Association and included by us at their suggestion. It has as its purpose reassuring the REA—or let me be more precise—assuring the REA that it would continue to have its current existing right to use either the FFB or non-Federal security markets. We appreciate their cooperation in making that suggestion. If there is any further remaining uncertainty as to whether section 4 does the job, we would like to work with you. It is your language and we think it takes care of that.

I would like to say—and I do not want to gloss over differences—the principal difference seems to be the question of whether it would be on budget or off budget, and there is a difference of opinion on that.

I just would like to state for the record that the budget resolution passed by both Houses last year expressed the sense of Congress that this issue be addressed. And the Bielenson task force, which is looking into the whole question of the budget, proposes

language which would implement this change of bringing the Federal Financing Bank on budget.

That does not make it right. I am really not arguing the point. But I did want to indicate that there have been some recommendations in support of this concept which have come quite independently of the efforts by Senator Trible or by me on this subject. It is just something that will have to be sorted out if we ever go to markup on this bill.

I again want to thank you, Mr. Chairman, for this time and thank both witnesses for their very useful testimony.

Mr. GIBBONS. Are there any other questions? If not, thanks very much to our panelists, and this will conclude this morning's hearing.

Mr. GRADISON. Mr. Chairman.

Mr. PEASE. Yes, Mr. Gradison.

Mr. GRADISON. If I might, Mr. Chairman, I would like to indicate, as a sponsor of this bill, a strong desire to work with all the witnesses and anyone else who has not appeared but who might have concerns to see whether some of the problems which have been raised in this hearing could be dealt with by appropriate amendments which could be offered at markup. We will certainly take the initiative in reaching out to the people who have taken the time to come so that these matters can be worked out.

And we very much would appreciate assistance from the staff of the committee itself which has unusual know-how in this field and with whose help we believe we have a chance to put together a bill which could command broad support from the Committee on Ways and Means.

I thank the chairman.

Mr. PEASE. This concludes the morning's hearing.

[Whereupon, at 11:10 a.m., the hearing was adjourned.]

[Submissions for the record follow:]

STATEMENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

The National Association of Manufacturers (NAM) appreciates this opportunity to submit comments on H.R. 4629, the Truth in Budgeting Act of 1984. NAM is a voluntary business organization of over 13,500 corporations, large and small, located in every state. Eighty percent of the firms are considered small businesses. NAM member companies employ 85% of all workers in manufacturing and produce over 80 percent of the nation's manufactured goods. NAM is affiliated with an additional 158,000 businesses through its Association Council and the National Industrial Council.

The National Association of Manufacturers commends this Committee for its efforts to require that programs financed through the Federal Financing Bank (FFB) be included in the unified budget. As you are well aware, the Fiscal Year 1984 budget may actually understate the federal deficit by as much as $13 billion due to "off-budget" expenditures. Off-budget activities are exempt from the provisions of the Congressional Impoundment and Budget Control Act of 1974 and thus, are not subject to the authorizations-appropriations process that is applied to other Federal outlays. Since approximately 79% of FY 84 off-budget spending is attributable to the transactions of the FFB, requiring FFB activities to be included in the unified budget would ensure a more accurate and comprehensive financial statement of federal spending.

NAM has consistently endorsed efforts to bring all federal spending into the unified budget. On January 29, 1981, Alexander Trowbridge, president of NAM, stated in testimony before the House Budget Committee that, "* * * off-budget loans by the federal agencies must be brought under control by the Congress * * * It is time to bring all federal spending transactions under one roof. Nothing is gained by placing some spending out of sight. That's like putting your credit card bills out of sight when it is actually your credit card that should be put away. Congress should con-

solidate all of its spending and borrowing responsibilities so they can be reviewed and a true fiscal picture can be developed."

In testimony presented before the House Rules Committee Task Force on the Budget Process in April 1983, NAM witness Arthur House, vice president of government and industry relations for CIGNA Corporation, reiterated our position regarding a unified budget. He stated, "NAM continues to believe that all federal spending and revenues should be included in unified budget totals. We contend that off-budget spending should be transferred on-budget all at once.

In addition to addressing the need to bring federal spending into the unified budget, the Truth In Budgeting Act remedies a number of other problems that have plagued federal credit activities in the past. In the last few years, Congress has attempted to bring the same discipline to its credit procedures that it has imposed on other spending activities. One way this has been achieved is through the creation of a credit budget now included in congressional budget resolutions. Generally, the credit levels were provided merely as recommendations and were nonbinding. However, as the importance of these programs became more apparent and the ability to effectively calculate the costs associated with credit activities improved, strong consideration was given to make the limits binding.

NAM believes that establishing binding credit levels is an important step towards the development of a responsible fiscal spending plan. Currently, the recommended credit levels are being circumvented by agency accounting practices. The Truth In Budgeting Act would amend these practices, thus providing more effective enforcement of specified credit limits and making each agency more accountable for its credit activities. Currently, when a federal agency provides a direct loan to an individual or business, the transaction is credited against the amount allocated in the agency's budget and in the budget resolution for that purpose. However, a change in the accounting procedure occurs when an agency sells the direct loan to the FFB. As explained in the Senate Budget Committee's Report No. 97-49 which accompanied S. Con. Res. 19 (the first budget resolution for FY 82), "* * * the FFB purchases direct loans made by an agency or certificates of beneficial ownership (promise of repayment without transfer of the loan). This transaction is treated as an offsetting collection, reducing the on-budget outlays of the lending agency and increasing the off-budget outlays of the FFB."

For example, if an agency has a $3 billion lending limit, it could make a $3 billion direct loan to an individual. If it then sells the $3 billion loan to the FFB, there is no reduction in the agency's outlays at the end of the transaction. The agency is then free to negotiate another direct loan for $3 billion without exceeding its credit limit.

H.R. 4629 remedies this problem by requiring agencies to subtract these sales of direct loans or loan guarantees to the FFB from their outlays. Each FFB transaction would be recorded in full in the originating agency's outlays. The result would be the discontinuation of the underreporting of credit activities by agencies accompanied by a more accurate accounting of the federal level of participation in the credit markets. It would also force all credit transactions to be counted against an agency's credit limit established in a budget resolution in contrast to the current practice of accounting only for those that remain on-budget.

Another problem which is addressed by the Truth in Budgeting Act is the current ability of a federal agency to transform a loan guarantee into an off-budget direct loan. Many times, through accounting procedures, congressionally mandated loan guarantees are converted into federal direct loans. If an agency sells a loan it has guaranteed to the FFB, the FFB then provides the direct loan. As a result, the federal loan guarantee is transformed into an off-budget direct loan. NAM believes that this practice contradicts the congressional intent of many loan guarantees programs and should be rectified. While H.R. 4629 does not deny an agency the ability to transfer a guaranteed loan into a direct loan, it does require agencies selling loan guarantees to the FFB to request an equivalent level of budget authority and charge the amount of the loan to the agency's account. This should also enhance the ability of Congress to better calculate federal levels of loan activity and more effectively monitor agency lending levels.

In October 1983, NAM submitted comments to the Senate Banking Committee endorsing S. 1679, The Honest Budgeting Act of 1983. At that time, NAM urged the Senate Banking Committee to examine current credit practices to determine if Congress is providing unintentional loan subsidies. As H.R. 4629 is further considered, we urge this Committee to do the same. Again, as stated in the Senate Report accompanying the FY 1982 first budget resolution, "Federal direct loans, loan guarantees, and those preferential interest rates or tax treatment afforded those loans are presumably intended to allocate credit in a manner different from that which would

result without Federal influence. It must, therefore, be true that borrowers receiving guaranteed or direct loans receive terms more favorable than they would receive in private capital markets."

If, as stated, a federal loan guarantee or direct loan includes a subsidy that would not be available without federal backing, than a federal loan guarantee that is transformed into a direct loan through the FFB may be receiving a double subsidy. It should be questioned whether this is the original intent of the drafters of the Federal Financing Bank Act. By requiring each credit transaction to be counted against an agency's allocation, it should be easier for Congress to determine if it is providing a subsidy to a borrower which is greater than was originally intended.

Many of the recommendations regarding federal lending practices contained in this statement were developed in response to a specific request by Senator Pete Domenici, chairman, Senate Budget Committee, for NAM to comment on federal budget policies and practices. In 1983, NAM's Fiscal and Monetary Policy Committee established working task forces which reviewed specific areas of the budget, including entitlement reform, reconciliation, impoundments, credit activities and the prospect of moving toward a multi-year budget. A copy of the final recommendations that were submitted to Senator Domenici is attached. I hope this information will be helpful and that it will be considered along with this legislation or as part of other efforts to strengthen and further define federal credit procedures.

Again, NAM appreciates this opportunity to submit our views to the Committee. NAM fully supports your efforts and we look forward to working closely with you in the near future on this important issue.

NATIONAL ASSOCIATION OF MANUFACTURERS,
Washington, D.C., October 13, 1983.

Senator PETER V. DOMENICI,
U.S. Senate,
Washington, D.C.

DEAR SENATOR DOMENICI: The National Association of Manufacturer's (NAM) Fiscal and Monetary Policy Committee welcomes this opportunity to present our views on specific budget policy and procedural reform. In response to your letter of September 24, 1982, we created five task forces to examine some of the specific subjects you highlighted.

Specifically, small working groups met to evaluate progress in the areas of multi-year budgeting, impoundment procedures, entitlements, federal credit activity, and the reconciliation process. Knowledgeable representatives from Congress and the Office of Management and Budget were invited by several of the task forces to present their views on the current situation and to offer their recommendations for reform. As is evident by the following recommendations, many hours of consideration were devoted by our members to this project.

Prior to a discussion of the five specific areas of concern, it is necessary to reiterate an important point emphasized in past testimony. The NAM continues to believe that all federal spending and revenues should be included in the unified budget totals. Past and current projections of budget deficits have fallen short of stating the true amount of federal indebtedness because a portion of federal spending, commonly referred to as off-budget outlays, is never included in budget total estimates. We contend that all off-budget spending should be transferred on-budget all at once.

With this measure of budgetary control as a base, we present the following broader recommendations:

A. FEDERAL CREDIT ACTIVITY

The National Association of Manufacturers has long recognized the importance and impact of federal credit activity on the national economy. The growth of these programs has contributed to the significant increase in government absorption of available credit. This in turn has made it more difficult for private industry to service its own borrowing requirements, which has resulted in slower rates of capital investment and job creation.

The magnitude of federal credit has been largely overlooked due to a lack of uniform accounting procedures among borrowers and lenders. Comprehensive statistics are essential to determine the full extent of federal credit liability. If the growth of these programs is to be effectively managed, we must begin to address the issue now. The National Association of Manufacturers' Fiscal and Monetary Policy Committee therefore recommends the following:

1. Congress, the Office of Management and Budget (OMB), the Congressional Budget Office (CBO) and the General Accounting Office (GAO) should agree on the definitions for all credit terminology. Currently, major differences exist in the interpretation of these terms. A unified effort would produce the reliable data necessary to assess and establish reponsible levels of federal credit activity.

2. Binding limits should be established in the budget resolutions for all federal credit activities. These limits should then be enforced through the congressional authorizations and appropriations processes, primarily through dollar appropriation limitations on credit activity. In order to unify federal spending and credit activities, an equivalent degree of control should be exercised over credit and direct spending programs.

The language necessary to implement these changes has been developed and was included in the First Concurrent Resolution on the Budget for FY 1983. Similar language should become a standard part of the FY 1984 and subsequent budget resolutions and a part of the Congressional Budget and Impoundment Control Act of 1974.

3. The federal government's total credit liability should be included in both the President's budget and in the reports accompanying all budget resolutions emanating from Congress to highlight the extent of federal involvement in credit markets. In addition, default rates for individual programs should be included in the President's budget to assist in program management and congressional oversight activities.

4. Funds for credit activities should be subject to the same impoundment and reconciliation procedures that are included in the Budget Act for other types of federal funds.

5. As part of its oversight responsibilities, Congress should review all credit programs. Priority for federal funds should be established based on need, program efficiency and cost-effectiveness.

6. Comprehensive statistics on all federal lending activities should be compiled and a periodic analysis of all federal credit programs should be prepared. Development of a credit budget, studies requested by congressional committees, and computer scorekeeping capabilities developed by the Congressional Budget Office have all been helpful in providing the necessary information, but more is needed to establish an accurate assessment of our government's credit obligations.

Many of these recommendations stem from the realization that budgetary treatment of credit practices has been less than that for taxes or direct spending. Credit programs must be subject to the same scrutiny that is afforded by Congress for all federal spending.

B. MULTIYEAR BUDGETING

The NAM supports the purpose and objectives of the Congressional Budget and Impoundment Control Act of 1974. However, the ability of Congress to adhere to the timetable of the Budget Act has declined markedly since the process was initiated, substantially curtailing the ability of Congress to review other legislative issues.

Our Fiscal Policy Committee endorses the concept and benefits of multi-year budgeting. Specifically, the Committee recommends a biennial budget process. The cycle should begin in the first session of each Congress. A budget resolution and all authorization and appropriations bills should be passed in the first year of the cycle, leaving the second year open for oversight and other legislation. In addition, the Fiscal Policy Committee believes that a number of issues related to the budget process need to be addressed and therefore recommends that:

1. A single set of economic assumptions should be agreed upon for all budget proposals by the Congress and the Administration.

2. The first concurrent budget resolution shall be made binding and the mandatory second concurrent budget resolution shall be eliminated.

3. Congress shall have the option to attach reconciliation instructions to concurrent budget resolutions.

4. Any modification of a budget resolution to increase spending shall require a super-majority vote.

C. IMPOUNDMENT PROCEDURES

We further believe that the impoundment procedure contained in the Congressional Budget and Impoundment Control Act of 1974 are adequate for providing congressional control over the impoundment of funds by the executive branch.

While this executive authority to impound funds may be useful to prevent unnecessary expenditures, it should not be used as a primary tool to reduce federal spending and deficit levels. Policy and program revisions to control the growth of federal

spending should be accomplished through the authorization and appropriations processes.

NAM's Fiscal Policy Committee believes that the President should retain the authority to rescind and defer federal expenditures. Therefore, before any changes are made in the Budget Act regarding impoundment procedures, Congress should consider the following recommendations:

1. Line item veto authority should not be granted.

2. The provision of Title X, Section 1001(4) of the Budget Act, known as the "Fourth Disclaimer" [1], should be clarified. This provision attempts to define which federal appropriations are subject to impoundment by the President. The Congress, the Office of Management and Budget (OMB), and the General Accounting Office (GAO) differ in their interpretation of the duration and scope of this provision. We believe that:

The Fourth Disclaimer was intended to be permanent, rather than a temporary, provision of law.

Only entitlements [2], as narrowly defined by Title IV Section 401(c)(2)(C) of the Budget Act, should not be subject to Presidential impoundment.

D. ENTITLEMENT REFORM

The NAM has long been concerned with the growth in entitlement programs and their impact on the economy. The "uncontrollable" nature of these programs has hindered numerous efforts aimed at bringing federal spending more in line with revenues.

Our Fiscal Policy Committee believes that entitlement reform should be undertaken to ensure that necessary programs accomplish their objectives in an efficient and cost-effective manner. This entitlement reform can be achieved through existing congressional oversight procedures. However, the procedures must be strengthened to ensure greater congressional accountability.

The business community has its own responsibility in these efforts. Recommendation and implementation of constructive alternatives will assist in reforming entitlement programs. Successful entitlement reform initiatives will lead to the achievement of the common goal of economic stability. Therefore, we recommend the following:

1. The congressional authorization committees should study all entitlement programs within their jurisdiction to determine which programs, if any, should remain as entitlements and which can be reconstituted as regularly authorized and appropriated programs. Pursuant to this task, Congress should determine if the original purpose of the program is still valid; if the eligibility criteria are too broad; and whether benefits are excessive.

2. Congress should not create any new entitlement programs. This would not preclude Congress from creating new programs. Rather, it would ensure congressional control of spending levels that would otherwise be relinguished if the benefits were established as entitlements.

3. Automatic cost-of-living adjustments for entitlement programs should be eliminated. Any periodic adjustments that Congress deems necessary should require a recorded vote.

4. A congressional study should be initiated to evaluate the feasibility of the private sector administration and/or management of federal entitlement programs.

5. Uniform scorekeeping measures should be adopted by both Houses of Congress. The current methods used by the House and Senate differ in the way they assess spending levels, thereby producing misleading comparisons.

---

[1] Fourth Disclaimer, as defined in the Congressional Budget and Impoundment Control Act, Public Law 93-344, 31 USC 1401: Title X—Section 1001. Nothing contained in the Act, or in any amendments made by this Act, shall be construed as—(4) Superseding any provision of law which requires the obligation of budget authority or the making of outlays thereunder.

[2] Entitlements, as defined in the Budget Act, Public Law 93-344 USC 1351: Title IV—Section 401. (c) Definitions.—(2) For purposes of paragraph (1), the term "spending authority" means authority (whether temporary or permanent)—(C) to make payments (including loans and grants), the budget authority for which is not provided for in advance by appropriations Acts, to any person or government if, under the provisions of the law containing such authority, the United States is obligated to make such payments to persons or governments who meet the requirements established by such law. Such term does not include authority to insure or guarantee the repayment of indebtedness incurred by another person or government.

E. RECONCILIATION

NAM's Fiscal and Monetary Policy Committee believes that in order to maintain the integrity of the congressional budget process, enforcement mechanisms, such as reconciliation, are necessary. However, as Congress has expanded its use of reconciliation in the past few years, it has become apparent the process needs to be strengthened and defined in order to help achieve fiscal discipline. Therefore, we recommend the following:

1. The first concurrent budget resolution should be made binding and the mandatory second concurrent budget resolution shall be eliminated. In addition, Congress shall have the option to attach reconciliation instructions to concurrent budget resolutions.

2. The current statutory ten day limit for Congress to complete action on a reconciliation bill or resolution, included in Title III, Section 310(d) of the Congressional Budget and Impoundment Control Act of 1974, is insufficient. The time restraints included in the Budget Act were associated with the need for Congress to adopt a second concurrenty budget resolution and reconciliation, if mandated, prior to the beginning of a new fiscal year, October 1. With our recommendation to require only one concurrent budget resolution, these time constraints are mitigated. We look forward to working with Congress to determine a more appropriate timetable for committees to make their recommendations to fulfill congressional action on a reconciliation bill or resolution.

3. The Budget Committees and Congress should codify the option to include provisions for reducing spending for both discretionary programs and entitlements in reconciliation instructions.

4. The amount of savings achieved in reconciliation bills shall be measured on the same basis used by the budget resolution which required them.

In conclusion, we would again like to thank you for this opportunity to present our proposals for budget reform. Our members gained a great deal of knowledge and a better understanding of the process while developing these recommendations. This insight will serve as an excellent basis for our future consideration of budgeting procedures.

Sincerely,

A. B. TROWBRIDGE.

STATEMENT OF CHARLES H. DEAN, JR., CHAIRMAN, TENNESSEE VALLEY AUTHORITY

On behalf of the Tennessee Valley Authority, I appreciate the opportunity to support this committee's efforts to reestablish control over Federal spending and credit programs. We recognize that some Federal programs are entering into obligations—for which the Nation's taxpayers will be responsible—far beyond the figures actually shown in the unified budget. We also recongize that for Congress to get a better handle on the true scope of these programs and what they mean to future taxpayer liability, the unified budget must become a more accurate measure of taxpayer expenditures and taxpayer obligations. We support legislation that will achieve these objectives.

We want to thank Representative Gradison, the sponsor of H.R. 4629, and his staff for recongizing the unique characteristics of the TVA electric power porgram's financial transactions and the needs of that program and for making special provision for those needs in the bill. We are, however, suggesting a technical amendment to the provision already included in the bill for TVA to—

(1) Ensure that TVA can continue to exercise its discretion to select the lowest cost financing available—the FFB or elsewhere—for its self-financing electric power system; and

(2) Ensure that the language of section 2 of the bill cannot be interpreted to aid either OMB or TVA in their disagreement as to the proper method of accounting for TVA power program activities in the Budget of the United States.

This technical amendment has already been agreed to be Senator Trible, the sponsor of the companion bill in the Senate, and we urge that it also be incorporated into H.R. 4629.

Because of the nature of this committee's jurisdiction, it rarely has the occasion to examine TVA's elecrtic power program. Yet, an understanding of that program—its unique financial arrangements and its history—is necessary to appreciate why it is as involved in Federal lending and credit matters as it is and why a special provision in H.R. 4629 is so necessary.

TVA ELECTRIC POWER PROGRAM

The TVA power program, now in its 51st year, is the sole source of power supply in all or portions of 170 counties in a 7-State area. It serves more than 7 million residential, commercial, and industrial consumers—some directly but most through 160 municipal and cooperative distribution systems.

From a financial standpoint, the most important thing to remember is that the Nation's taxpayers do not back the TVA power program. Taxpayers do not pay for the program. Taxpayers are not responsible for power program debts. Taxpayers do not subsidize the program. And, taxpayers are reaping substantial return on the money the Government originally invested in the power program. Last year, for example, TVA power program consumers paid the Treasury a $106 million dividend on this investment—a return of more than 12 percent.

FINANCING OF TVA POWER PROGRAM

The TVA power program is unlike any other federally owned undertaking from a financial standpoint. It is entirely self-financing, although all of its assets are owned by the United States. Before 1959, the TVA power program financied itself through revenues from the sale of electric power and through congressional appropriations that paid for much of the original capital investment. As mentioned above, that appropriation investment is being repaid with dividends. Since the 1959 Self-Financing Amendment, however, TVA's own borrowings and revenues have replaced appropriations as the source of funds for capital investment. The Self-Financing Amendment prohibits power program borrowings from being obligations of or guaranteed by the United States. TVA is required by this law to charge electric rates that are high enough to pay all its operating costs, make in-lieu-of-tax payaments to State and local governments, repay the Government's original investment with dividends, meet the financial obligations contained in the bonds it has issued to borrow money, and provide such additional financial margin as TVA considers desirable.

Until the Federal Financing Bank began operation in 1974, TVA borrowed most of its money by selling short-term notes and long-term bonds to private investors. The bonds were always rated as triple-A securities and retain that rating today. Many of these outstanding bonds are traded on the New York Stock Exchange.

After it became clear that the Federal Financing Bank could loan TVA money at a lower interest rate than it was receiving on the market, TVA began borrowing from the FFB. Because the FFB has continued to offer a lower rate than that available in the market, all TVA direct borrowing since 1974 has been from it.

SEVEN STATES ENERGY CORPORATION

TVA finances its nuclear power plant fuel, which is regarded as a capital item, in somewhat different manner, although the FFB has been the ultimate source of this financing as well.

Since 1979, all of TVA's nuclear fuel has been owned by the Seven States Energy Corporation, a wholly owned subsidiary of a California banking corporation. Seven States leases the fuel back to TVA when it is needed in a nuclear power plant. In the meantine, Seven States finances the stockpile of fuel it owns by borrowing from the FFB on the basis of its lease arrangement with TVA, which the FFB regards as a guarantee for these loans.

The process of mining, milling, and enriching uranium and fabricating nuclear fuel takes several years. The purpose of the nuclear fuel lease with Seven States is to postpone putting any of these costs into electric rates until the fuel is actually created and used.

This kind of arrangement is common among electric utilities. At first, we planned to have this nuclear fuel arrangement fianced in the private financial market. It was the FFB that requested the financing be handled through it, and it helped create the present arrangements.

Although this financing is indirect, TVA is ultimately responsbile for this debt just as it is responsible for its direct borrowing. The obligation to make payments under the nuclear fuel lease is TVA's, not the American taxpayer's, and for the purposes of this bill it should be treated the same as TVA's direct borrowings.

Incidentally, the legislation before this committee has already resulted in improvements to the Budget of the United States. The predecessor bills to H.R. 4629 highlighted an accounting treatment of the Seven States transactions that caused them to be erroneously shown in the FFB's credit activity budget at a level 34 times larger than their actual level and accounting for more than 26 percent of the FFB's total credit activities. In actuality, Seven States transactions accounted for less than

2 percent of the total FFB credit budget. Fortunately, this overstatement has been corrected by OMB and CBO in the fiscal year 1985 budget.

NEED FOR THE SPECIAL TVA PROVISION IN H.R. 4629

As explained at the beginning of this statement, a special provision is needed in H.R. 4629 to take into account the unique financial activities of the TVA power system, and we are grateful to Representative Gradison for recognizing this.

The bill's requirement that all direct agency borrowings and all agency-guaranteed borrowings be first offered to the Federal Financing Bank under Treasury Department regulations would pose two problems for TVA. First, it could prevent the TVA power system from being able to borrow from the public if it were cheaper to do so. For example, if the FFB raises its funds by selling its own securities to the public, rather than to the treasury, its cost of money will probably incease. In addition, regardless of its source of funds, the FFB has the authority to "mark up" its funds to borrowers by any amount it chooses. Second, it would give the Secretary of the Treasury undue control over TVA's borrowing activities.

Prior to 1959, actions by Government officials were instrumental in preventing TVA from obtaining all the capital it needed for building new electric power plants to keep pace with the growing demands for electric power. The 1959 Self-Financing Amendment was an express repudiation by Congress of this administrative restriction. The Amendment took four years to hammer out and established most of TVA's unique financial characteristics. Although the TVA Board always had the responsibility of providing a supply of electric power at the lowest feasible cost, the 1959 Amendment delegated to it the exclusive authority to decide how best to finance the power sytem to meet this responsibility. This authority is exercised without further executive branch or congressional approvals, within a $30 billion bond ceiling.

From 1960 to 1974, TVA borrowed the funds it needed from the only source available—the public market. With the creation of the FFB a second source became available at the option of the Treasury. In each instance since 1974, TVA has considered the cost of funds from each source and has obtained funds from the source that would cost electric power consumers the least. In every instance thus far, the lowest cost source has been the FFB, and we see no reason that this situation should change if the FFB continues its current operating and pricing practices. We do not have guaranteed access to the FFB and we seek no guarantee. We borrow from the FFB at the discretion of the Treasury. We do not want the rights or the obligations of FFB borrowings but are glad to continue the status quo using the FFB when it is mutually agreeable.

Should the FFB change its practices or another source of funds become available at a lower cost, TVA should be able to take advantage of that source for the benefit of its electricity consumers. A statutory or administrative prohibition preventing us from doing so would be contrary to TVA's statutory responsibility for making power available at the lowest feasible cost.

Equally as important, giving the Secretary of the Treasury first right of refusal on the purchase of TVA bonds or participation in other financial undertakings would give the Secretary the power to delay the financing TVA needs to conduct its power program for the benefit of its consumers and actual authority, if not outright legal authority, to control the terms and conditions of TVA's borrowings. After much debate, the 1959 Self-Financing Amendment relegated the role of the Secretary of the Treasury only to the timing of bond issues and the maximum interest rates that such bonds could bear so as not to interfere with the marketing of the Treasury's own securities. This relationship was preserved later in the FFB Act. Although section 7(a) of the FFB Act gave the Secretary broad authority over the manner, source, and terms and conditions of the financing of other Federal agencies, TVA was excluded from such additional authority.

In addition, section 2 of H.R. 4692 would enact a new section 11(c) to the FFB Act which would for the first time direct by statute a budgetary treatment of the TVA power system which has been followed by OMB, but which we think was not intended by Congress, has been opposed by three Senate committees, and is inconsistent with the Congressional Budget Act of 1974.

OMB does not agree that it has been presenting the TVA power system budget improperly. OMB claims that the power program's authority to borrow money constitutes "budget authority" and the expenditure of such money constitutes "outlays." TVA claims power program transactions cannot constitute "budget authority" or "outlays" because, among other reasons, these terms are defined by the Congressional Budget Act of 1974 in terms of "Government funds" and power program funds are not "Government funds." The present wording of the proposed new sec-

tion 11(c)(1) is not neutral on this issue. It would expressly require TVA power program transactions by the Seven States Energy Corporation (which is a form of indirect financing of the power program by TVA) to be shown in the Budget of the United States as "budget authority" and "outlays," thus enacting OMB's position into law. As a minimum, H.R. 4629 should remain neutral on this issue.

NEED FOR TECHNICAL AMENDMENT

At the beginning of this statement, I noted that a technical amendment is needed to—

(1) Ensure that TVA can continue to exercise its discretion to select the lowest cost financing available—the FFB or elsewhere—for its self-financing electric power system; and

(2) Ensure that the language of section 2 of the bill cannot be interpreted to aid either OMB or TVA in their disagreement as to the proper method of accounting for TVA power program activities in the Budget of the United States.

H.R. 4629 already contains a provision (section 7(a)(4) of the FFB Act as amended by section 3 of the bill) which Representative Gradison intended to take care of the first of these TVA problems. Unfortunately, the existing language is incomplete in that it applies only to TVA direct financing activities. An amendment to the language is needed to include TVA's indirect financing activities which are conducted with the Seven States Energy Corporation within the exclusion afforded by subsection (a)(4).

This is necessary for two reasons. First, the language, as drafted, could not apply to any indirect financing activity involving TVA. TVA power program assets are not pledged to secure its obligations. TVA pledges only future revenues. Second, the coverage of the new section 7(a) is in terms of "guaranteed obligations," yet paragraph (4) fashions its exclusion with the totally different terms of "funds disbursed pursuant to an agreement." The TVA exclusion should be in the same terms as the bill's coverage, or it may not actually exclude those activities that are intended.

A technical amendment is also needed to ensure that the new section 11(c)(1), which would be added to the FFB Act by section 2 of the bill, cannot be interpreted to aid either OMB or TVA in their disagreement as to the proper method of accounting for TVA power program activities in the Budget of the United States.

S. 2213, the companion bill in the Senate, incorporates the following technical amendment that would handle both problems. This amendment would replace the present TVA exclusion language (lines 19–24, page 3, of H.R. 4629) with the following:

"(4)(A) The provisions of this subsection shall not apply to an obligation issued, sold, or guaranteed by a Federal agency the obligations of which are issued pursuant to an Act of Congress which expressly prohibits any guarantee of such obligations by the United States.

"(B) Amounts of loans which are guaranteed by such Federal agency and which are financed by the Bank shall be recorded in such agency's budget in an appropriate manner. Any budget authority used by the Bank for such transaction shall be attributed to the Federal agency in an appropriate manner.".

We urge that this technical amendment be incorporated into H.R. 4629.

OMB has advised that: (1) it opposes the amendment (4)(B) that we have suggested; and (2) it opposes any specific exemption from on-budget accounting for TVA.

○